

**THE IMPACTS OF CANADA/U.S.
FREE TRADE ON THE YUKON ECONOMY:
FINAL REPORT**

**Submitted to:
Yukon Territorial Government
Economic Development,
Mines and Small Business**

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EXECUTIVE SUMMARY

The purpose of this report is to identify the advantages, disadvantages and risks of Canada-U.S. free trade to the Yukon economy and residents and to assist the Yukon government in preparing a bargaining strategy for the free trade negotiations between Canada and the United States. The report is based on the review of available documents on the Yukon and Alaska economies and the implications of free trade for Canada as a whole, interviews with government officials, business people and labour leaders in Yukon, and meetings with the Yukon Economic Council.

The economic context for the free trade debate is provided by the very serious Canadian recession of the first years of the 1980s, Canada's growing export dependence on the U.S. market, growing protectionist sentiment in the United States, the emergence of stiff competition from the newly industrializing countries, and the recognition that among the Western industrialized countries, Canada is virtually the only nation without free and secure access to a large market of more than 100 million people.

These forces were sufficiently persuasive to the Macdonald Commission for the Commissioners to propose that the Canadian government should pursue a free trade agreement with the United States. As well, the free trade debate arose at a very difficult time for the Yukon economy. The Territory has just suffered through its worst recession since the end of the Gold Rush. Another significant factor is the election of a new Yukon government in 1985 on a platform of targetted job creation, greater support to renewable resource activities, development of import substitution opportunities, and community based development.

The DPA Team's sector by sector analysis indicated that forestry, mining, transportation and distribution, and small-scale manufacturing could receive the greatest long-term benefits from a free trade agreement. The sectors least affected will be government, retail trade, tourism, hunting, trapping, fishing and energy, although even these could be affected to some degree. There are virtually no economic activities which face the risk of immediate job losses. The most significant costs will involve the time, effort and expense for some companies to adjust to a new economic and trading environment. Other dangers and risks include the possible limitations placed on the YTG in selecting economic policy instruments, the risk of under estimating potential competition from Alaskan businesses, and the danger (however remote) that the Pacific Rim could respond negatively to a Canada-U.S. free trade arrangement and reduce purchases from Canadian resource suppliers.

Many of the benefits and costs of free trade to Yukon are less than obvious and less than certain, and the actual impacts are difficult to identify and virtually impossible to quantify. Benefits and costs also depend on many forces

outside Yukon's control such as the value of the Canadian dollar, the strength of the Alaskan economy and the content of the final agreement.

Putting all qualifications aside, the judgement of the Study Team is that Yukon has comparatively little to lose and could receive significant long-term benefits from a free trade agreement with the United States. The most important potential benefits and opportunities include the following:

- . simplified customs procedures and the removal of custom brokerage fees should allow producers to make profitable smaller shipments to the Alaskan market and the lower 48 states;
- . freer access to the American market will assist small-scale manufacturers of specialty items, other Yukon producers and perhaps professional and business service firms;
- . free trade will better guarantee access to the U.S. market for Yukon resource producers;
- . free trade could result in the development of more efficient transportation and distribution systems and could effectively combine three markets -- South East Alaska, Yukon, and the MacKenzie Delta -- with a total population of nearly 100,000 people;
- . Yukon producers will clearly benefit from lower cost inputs, and Yukon consumers should benefit from lower prices.

To the extent that economic gains estimated in previous studies for the total country are realized in Yukon, free trade could add between \$600 and \$1300 to the average per capita incomes of Yukon residents. The realization of many opportunities however will require supporting and complementary initiatives by the Yukon and federal governments, including improved air links between Yukon and Alaska, improvements to the postal system between the two jurisdictions, other transportation and communication improvements, and financial and technical assistance to small Yukon companies to develop product and market niches.

A number of horizontal or economy wide issues will also need to be addressed by the YTG in developing its position on the free trade negotiation. These include the substantial differences in position between Yukon business people who generally support free trade and labour groups which are strongly opposed; the scope of the agreement; the need for a reasonable transition period and an effective dispute settlement mechanism, and the possibility that the agreement could inhibit the YTG in its efforts to diversify the Yukon economy.

The Study Team reviewed the literature regarding the benefits and costs of Canada-U.S. free trade to the Canadian economy and find the arguments in favour of free trade quite persuasive. We have also carefully reviewed the concerns of labour and other groups which are strongly opposed to Canada-U.S. free trade. The labour movement argues that a more desirable approach is to formulate and implement a Canadian industrial strategy, designed to strengthen Canadian industry, replace imports, diversify Canada's trading partners, and reduce Canada's overall dependence on foreign trade. While the alternative also has appeal, the YTG may wish to consider the following:

- . The National Policy of 1878, the only industrial strategy successfully implemented in Canada, operated to the benefit of Central Canada at the expense of the Atlantic, the West and the North.
- . Successful implementation of an industrial strategy requires broad consensus among regions and socioeconomic groups. After 20 years of debate, such a consensus remains as elusive as ever.
- . Raising tariff and non-tariff barriers will invite retaliation from Canada's trading partners.
- . With one-tenth of one percent of the Canadian population and one seat in the House of Commons, it is questionable whether Yukon interests would be better served if political decisions replace the market place as the primary force in guiding the destiny of the Canadian economy.

Based on these considerations and the analysis contained in the main report and four appendices, the Study Team proposes that the Yukon government support the start of negotiations with the United States on free trade and be prepared to provide qualified support to a free trade agreement. The support would be qualified in the sense that Yukon approval would be conditional upon certain requirements being met in the final agreement.

1. The agreement should be broad in scope and address tariff and non-tariff barriers, as well as trade in both goods and services.
2. The agreement should be open to participation from other countries and should not pose a threat -- or be perceived as a threat -- to third countries (especially in the Pacific Rim).
3. The free trade arrangement should not jeopardize Canada's international trading relationships and responsibilities.
4. The dispute settlement mechanism should be effective in resolving disputes between states and provinces/territories.

5. The transition period for implementing the arrangement in Canada should be no less than five years and should be significantly longer (by five years or more) than the American adjustment period.
6. The free trade agreement should in no way compromise Canada's social programs, or the ability of federal, provincial and territorial governments to provide economic development assistance to less developed regions and less advantaged groups.
7. Northern benefits packages and northern tax exemptions and credits should not be affected by a free trade agreement.
8. Canadian investment policies resulting either directly or indirectly from the agreement should facilitate access to the foreign investment needed for Yukon development, but should also allow the YTG to protect vulnerable industries from overinvestment and too rapid development.
9. The federal government should provide support to the improvements in transportation and communication systems needed to ensure that Yukon businesses and residents receive the greatest benefit possible from a successful free trade negotiation.

If the free trade negotiation moves in a direction which is unfavourable to these concerns, the YTG should reserve the right to withdraw its support for the negotiation and agreement. In preparing its position, the YTG may wish to consider holding meetings with: the governments of Alaska and the NWT to discuss issues of northern concern; British Columbia to discuss the implications for Pacific Rim trade; and other less industrialized provinces to discuss a common position on regional development programs. The Team's view is that the YTG should state its free trade position earlier than later, in order to have some influence on the Canadian negotiating position before it is firmly established.

1.0 BACKGROUND

The Royal Commission on the Economic Union and Development Prospects for Canada (the Macdonald Commission) recommended that the Government of Canada open negotiations with the Government of the United States to reach agreement on a substantial reduction of barriers, tariff and non-tariff, between our two countries. The recommendation in favour of free trade with the U.S. continues a debate which has been going on in Canada for well over a century, a period which includes the election of 1911 when a previous federal government ran and was defeated on a platform of Canada-U.S. free trade.

The current federal government has accepted the Commission's recommendation and announced in September, 1985 that the Government of Canada will begin free trade negotiations with the American government in the next year or so. The Prime Minister also indicated the federal government will consult closely with the provincial and territorial governments in developing the Canadian position for the free trade negotiations. As a consequence, a number of official and ministerial meetings have already been held, and free trade will likely be on the agenda of every First Ministers' conference until the negotiation is completed. The Yukon Government (YTG) concluded it was necessary to identify the advantages, disadvantages and risks of free trade to the Yukon economy and residents, and to prepare a bargaining strategy for the free trade negotiations.

In February 1986, the DPA Group Inc. of Vancouver was retained by the Yukon government to assist in the development of a YTG position for the free trade negotiations. This document represents the final report of the DPA Study Team. This report summarizes the findings and conclusions developed by the DPA Team during the two month assignment and is based on the following tasks:

- . Fairly detailed reviews of existing documents on the Yukon and Alaska economies and the Canada - U.S. free trade negotiations
- . Meetings held in Whitehorse during the week of February 24, 1986 with government officials, members of the Yukon Economic Council, and members of the business community and other interest groups in the Yukon
- . Discussions of the Alaskan market, other export markets, and possible implications of free trade, as part of a workshop on Import Substitution Opportunities held as one aspect of a companion study being conducted by DPA
- . Preparation of a working paper describing the opportunities and risks of free trade to different sectors of the Yukon economy, as well as horizontal free trade issues of particular importance to Yukon; (This working paper is included as Appendix A.)
- . Preparation and submission to the YTG of a discussion paper -- or interim report -- outlining the initial findings and conclusions of the Study Team. This paper was submitted during the week of March 17, 1986.
- . Presentation of the discussion paper to the Yukon Economic Council at a meeting held on March 25, 1986.
- . Additional personal and telephone interviews conducted in Whitehorse and Vancouver during the week of March 24, 1986. The names of all people interviewed during this assignment are listed at the end of this report.
- . Completion of three other working papers on the benefits and costs of free trade from a Canadian perspective, the Alaska economy, and barriers to trade in services. These papers are Appendices B, C, and D of this document.

This report, therefore, is based largely on existing documents, the experience and insights of government officials and business and labour leaders in the Yukon, and the experience gained by members of the DPA Study Team in previous work on the Yukon economy and on international trade. One purpose of the study was to identify subject areas and sensitive issues which could be considered for more detailed study.

This study largely assesses free trade from the perspective of the Yukon economy and the Territory's residents. At the same time, Appendix B provides a review of the literature on the benefits and costs of free trade to Canada as a whole. This review is briefly noted in the text. The Territory's residents are both Yukoners and Canadians. Our interviews indicated that Yukon residents would not be comfortable with a YTG position on an issue which, while clearly favourable to Yukon, was detrimental to the interests of Canada as a whole.

The remainder of this document includes four sections on the following:

- . Economic context for the free trade negotiations
- . Opportunities and risks of free trade to different sectors of the Yukon economy
- . Key issues to be addressed in developing the YTG position
- . Suggested position of the YTG on the free trade negotiations

2.0 ECONOMIC CONTEXT

The issue of a Canada-U.S. Free Trade Agreement has emerged during a period of growing uncertainty about the future prospects for the Canadian economy. A number of factors provide the context for the federal government's support of free trade negotiations with the United States:

- . the very serious Canadian economic recession of the first years of the 1980's (a recession from which only parts of the country have fully recovered)
- . Canada's growing export dependence on the U.S. market (despite efforts of thirty years to diversify our export sales)
- . growing protectionist sentiments in the U.S. government and among many American business and labour leaders, sentiments which pose an immediate threat to Canada's lumber exports and long-term threats to many other exports of commodities, semi-processed goods and finished products (it was not many years ago that powerful American politicians were threatening to unilaterally end the Canada - U.S. auto pact)
- . continuing Canadian support for the General Agreement for Tariffs and Trade, as well as recognition that the next round of multilateral trade negotiations could be the most difficult because of the anticipated focus on the non-tariff barriers to trade (NTBs)
- . emergence of stiff competition from the newly industrializing countries in Canada's domestic market and traditional export markets
- . recognition that among the Western industrialized countries, Canada is the only nation (with the possible exceptions of Australia and New Zealand) without free

access to a large market of more than 100 million people.

These forces were sufficiently persuasive to the Macdonald Commission for the Commissioners to argue that the Canadian government should pursue a free trade agreement with the United States.

The issue of free trade has also arisen at a very difficult time for the Yukon economy. Yukon has always been subject to wide fluctuations in economic activity, but the downturn of the last half decade was clearly the most serious Yukon recession since the end of the Gold Rush. Over the first five years of the 1980's, Yukon's gross territorial product fell by over a quarter and unemployment hit unprecedented levels of 15% plus. The closure of the Cyprus-Anvil mine and other hard-rock mining operations dramatized the vulnerability of the Yukon economy to international commodity markets and the danger of basing development almost totally on one sector, non-renewable resources. In 1985, a new government was elected in the Yukon on a platform of targetted job creation, greater support to renewable resource activities, developing import substitution opportunities, and community based development. The free trade issue posed essentially two questions for the new Yukon government.

What does free trade mean to the Yukon economy and residents?

How will free trade impede or enhance the YTG's efforts to encourage the development and diversification of the Yukon economy?

3.0 SECTORAL ANALYSIS

Exhibit 3.1 summarizes the opportunities and risks faced by each Yukon sector in the event that Canada - U.S. free trade becomes a reality. More detailed analyses are contained in Appendix A.

EXHIBIT 3.1: OPPORTUNITIES AND RISKS OF FREE TRADE BY YUKON SECTOR

Opportunities	Risks	Comments
1. Agriculture Simplified customs procedures and lower tariffs could open up Alaskan markets for specialty food items and horticulture products. Changes in transportation/distribution systems could also offer opportunities in S.E. Alaska and Beaufort.	Could result in lower priced imports from Alaska or California. However, Alaska and Yukon agriculture appear to be developing in a complementary manner, and current Alaskan prices are high.	Benefits appear greater than risks, but net impacts difficult to estimate and overall impacts likely to be small relative to total Yukon economy.
2. Forestry Logs and lumber currently enter U.S. duty free, but Yukon forestry development could be seriously inhibited until B.C. lumber dispute with U.S. is resolved. This may require a free-trade agreement. Removal of tariffs on more finished products could offer very long-term opportunities in Alaskan markets.	Alaskan producers do not compete in Yukon probably because of high Alaskan demand, the small size of the Yukon market and the attraction of large Pacific Rim markets.	Net impact should be positive, but most opportunities lie many years into the future.
3. Hunting and Trapping Possible benefits from lower cost supplies and from increased sales to Alaska of specialty items which include wild fur.	No risks were identified.	Free trade impacts likely will be minor.

EXHIBIT 3.1 Continued

Opportunities	Risks	Comments
4. Commercial and Subsistence Fishing Fishermen will benefit from lower cost supplies and simplified customs procedures which could facilitate exports of small shipments of specialty items.	No obvious risks, unless the salmon treaty negotiations become mixed up with the free trade negotiations. This would likely not be to the Yukon's benefit.	Free trade impact very small compared to successful resolution of salmon treaty amendment negotiations.
5. Mining Significant benefits from decreased costs of purchased inputs and guaranteed access to U.S. market. Possible longer-term opportunities for further processing of base metals in Yukon.	Danger of retaliation from Pacific Rim countries which could hurt current and future resource exports to that market. Danger may be slight, but should still be effectively addressed in free trade negotiation.	Yukon mining industry supports free trade. Benefits are seen as tangible and significant while risks are viewed as low.
6. Oil, Gas and Other Energy Sources More efficient transportation/distribution systems could expand Beaufort opportunities and reduced tariffs and non-tariff barriers could allow Yukon companies to better compete for North Slope business.	Could mean greater competition from Alaskan companies if Yukon resources are developed at some point in the future.	Except for more secure access to U.S. markets, free trade will have little effect on development of Yukon energy resources. Development of Yukon resources, plus North Slope and Beaufort development, will depend on international energy prices.

EXHIBIT 3.1 Continued

Opportunities	Risks	Comments
7. Tourism Direct effects minimal, but longer-term consequences could be fairly important. These include: lower costs of supplies; greater two-way flow of goods and people between Alaska and Yukon; closer business ties; and removal of irritants which hinder tourist promotion in the U.S.	Yukon retailers could be hurt by removal of restrictions on duty-free purchases of Canadians visiting the U.S. Closer ties could mean greater U.S. investment in Yukon tourism industry; some Yukoners may view this development with concern.	Indirect longer-term effects should be positive and quite significant as long as increased American investment is not seen as a threat, and tourism growth is properly managed to limit resource use conflicts.
8. Construction Relaxation of non-tariff barriers could allow Yukon contractors to better compete for Alaskan contracts and to more easily establish Alaskan operations and joint ventures with Alaskan companies. Also lower barriers enhance potential for information and technology exchange with Alaska and for moving equipment back and forth across the border.	Greater competition in Yukon market from Alaskan companies.	Opportunities and risks should be quite small. Free trade will not change the strong local market orientation of the construction industry.
9. Transportation, Wholesale and Distribution Yukon companies could benefit significantly from improvements to transportation systems, and from Whitehorse's central position in a transportation network encompassing the	Time, effort and expense for Yukon businesses to adjust to the new environment and develop new business links; and increased competition from	Transportation and distribution could be the sectors which are most affected by free trade but more research is needed. As well, anticipated benefits

EXHIBIT 3.1 Continued

Opportunities	Risks	Comments
Alaska Highway and the Dempster Corridor. This would effectively combine three markets (SE Alaska, Yukon, Mackenzie Delta) with a total population of nearly 100,000.	Alaskan businesses.	will require supporting initiatives to improve air links, postal system etc. between Alaska and Yukon.
10. Business and Professional Services Yukon based companies could benefit from better access to Alaskan market (trade in services will be a priority of U.S. government). Because of quality of life, Whitehorse could be a good central location to serve northern market which combines Alaska, Yukon and NWT.	Increased competition from Alaskan businesses and companies based in other parts of Canada (given that free trade could reduce NTBs and inter-provincial barriers to trade in services).	Free trade, by better combining northern markets (Alaska, Yukon, NWT) could result in greater specialization of business services between Alaska, Yukon, and NWT to the benefit of all three jurisdictions.
11. Retail Trade Reduced transportation costs and wholesale prices which could allow retailers to increase profit margins. Expanded retail sales based on improved transportation systems, lower prices, etc. Expanded franchising opportunities in Alaska. Overall economic gains from free trade which should expand retail sales.	Need to adjust to the new climate and develop new links with wholesalers, transportation firms, etc. Better opportunities for Yukon residents to shop in Alaska (if Yukon prices are out of line).	Retailers in general will face new competition and pressures to keep their prices competitive.

EXHIBIT 3.1 Continued

Opportunities

Risks

Comments

12. Government

Reduced prices for government procurement, based on lower tariffs and non-tariff barriers with U.S. and reduced barriers to inter-provincial trade (e.g., provincial preference policies) in Canada. Lower consumer prices could reduce upward pressure on government wages.

Reduced latitude to use government procurement as a development tool.

Government will likely be the sector least affected by free trade.

The exhibit indicates that the Yukon sectors which likely will receive the greatest long term benefit from free trade are forestry, mining, transportation and distribution, and small-scale manufacturing. The sectors least affected will be government, retail trade, tourism, hunting, trapping, fishing, and energy, although even these economic activities could be affected to some degree.

There are virtually no Yukon economic activities which face the risk of immediate job losses. The most significant costs will involve the time, effort and expense for some companies in the transportation, wholesale and retail sectors to adjust to a new economic and trading environment. Many of the benefits and costs of free trade to Yukon are less than obvious and less than certain, and a number of impacts could occur many years in the future. The actual impacts are difficult to identify -- and virtually impossible to quantify -- because the benefits and costs are based on how different actors (Yukon government, business people, interest groups, and workers) respond to the challenges and opportunities posed by a free trade agreement. Benefits and costs also depend on many forces outside the Yukon's control: the value of the Canadian dollar versus the American dollar; the strength of the Alaskan economy; relative prices and costs between Yukon and Alaska; and of course the form and content of the Canada-U.S. free trade agreement.

Putting all qualifications aside, the judgement of the Study Team is that the Yukon has comparatively little to lose and could receive significant long term benefit from a free trade agreement with the United States.

The most important potential benefits and opportunities include the following:

1. Simplified customs procedures and the removal of custom brokerage fees should allow producers to make profitable smaller shipments to the Alaskan market and the lower 48

states, and will facilitate promotion and test marketing by manufacturers, tourist operators and other businesses.

2. Free trade will fully remove US tariffs -- some of which are still high -- and should reduce American non-tariff barriers. Freer access to the American market will assist small scale manufacturers of specialty items, other Yukon producers, and perhaps some professional and business service firms based in Yukon.
3. Free trade will better guarantee access to the U.S. market for Yukon resource producers. This could particularly benefit the Yukon forestry sector, which at this time is indirectly constrained by the B.C. lumber dispute with the United States.
4. Free trade could hold significant potential to result in the development of more efficient transportation and distribution systems. More efficient systems should reduce consumer prices and could provide opportunities for Yukon transportation and wholesale firms to expand their volumes. Under free trade, Whitehorse could become the central node in a transportation network which would link up the Alaska Highway (from Edmonton to Whitehorse) and the Dempster Corridor (from Skagway to the Mackenzie Delta). Free trade would effectively combine three markets: Southeast Alaska, Yukon, and the Mackenzie Delta, with a total population of nearly 100,000.
5. Yukon producers will clearly benefit from lower cost inputs, and Yukon consumers should benefit from lower prices (although some question whether the cost savings will be passed on to the final consumer. Our view is that most of the savings will be passed on, but this process may not occur immediately or automatically.).

The realization of many opportunities, however, will require supporting and complementary initiatives by the Yukon and federal governments, including: improvements to the air links between Yukon and Alaska; improvements to the postal and other communication systems between the two jurisdictions; other transportation improvements in the Yukon (e.g. further upgrading of the Alaska Highway, and implementing the recommendations of the Prolog Study for the Dempster Corridor); financial and technical assistance to small Yukon companies to develop product and market niches to replace imports during the transition period and expand export sales once the free trade agreement is fully implemented. As well, Yukon firms that have conducted business in Alaska stated that banks and insurance companies with offices in Whitehorse need to expand their Yukon capabilities and expertise to better support cross-border business transactions.

The greatest danger to the Yukon government is that the content of the free trade agreement -- together with complementary federal actions to reduce the federal deficit -- could seriously curtail the YTG's ability to influence the future direction of Yukon economic development. The danger from free trade in this respect may be slight -- the greater danger probably comes directly from federal government expenditure cutbacks -- but this danger should still be clearly addressed in developing the YTG position on Canada-U.S. free trade. A second danger is that potential competition from Alaska could be seriously underestimated.

The Study Team offers these conclusions with the full knowledge that the information base we are working from is quite limited. Three areas for further study are offered for consideration.

- a study of current and future developments in the Alaskan economy, of the opportunities and risks posed by Alaska in the event of free trade, and of the actions

required by the federal and Yukon governments to realize Alaskan opportunities

- research on the impacts of free trade on the transportation, communications, wholesale, distribution and retail sectors, and the actions required by government to realize opportunities, minimize costs and ensure that cost savings are passed on to Yukon businesses (on their non-wage expenditures) and to the Yukon consumer.
- more detailed case studies of the opportunities and risks of free trade for specific industries; possible candidates include small-scale manufacturing, agriculture, construction, and business and professional services.

As well, it is proposed that Alaskan market opportunities, both under the present trading system and under a free trade arrangement, be made an element of the terms of reference for market and feasibility studies funded by the YTG or the federal government over the next number of years. This will further expand the information base on the Alaskan market and potential Alaskan competition in the event that Canada-U.S. free trade becomes a reality.

4.0 HORIZONTAL ISSUES

A number of horizontal or economy wide issues will also need to be addressed by the YTG in developing the Yukon position on the free trade negotiations. These are also assessed in some detail in Appendix A. Some of the most important are discussed below.

Consumers should benefit from lower retail prices -- which could be reduced by 5% or more -- but only if lower wholesale

prices and transportation costs are passed on to the final consumer. Good arguments can be offered that most of these cost savings ultimately will be passed on, but this subject area -- and the YTG actions needed to ensure lower consumer prices -- require further research. This issue is further discussed in Appendix A.

The Yukon business community can be expected to support a free trade agreement. Its support is based on lower priced supplies, the removal of Canadian and U.S. tariffs, guaranteed access to the U.S. (especially Alaskan) market, and the potential for more efficient transportation and distribution networks. Business support however also appears to be based on limited knowledge of the Alaskan market, and of potential competition from the state especially now that the Alaskan boom has ended.

Labour groups can be expected to oppose a free trade arrangement. The YTG may or may not agree with labour's position, but should recognize that labour has legitimate concerns which should be fully addressed in federal-provincial/territorial discussions and in the free trade negotiations.

The scope of the agreement would be very important to the Yukon. Yukon would probably receive no benefit from sectoral arrangements, and only limited benefits from a functional agreement which for example resulted in the removal of tariffs on goods, but addressed no other trade barriers, economic sectors, or issues. Yukon benefits appear to expand in direct proportion to the scope of the agreement. This judgement reflects not only anticipated impacts and effects on current economic activities but also, just as important, concerns that a narrow agreement could foreclose future options and opportunities for the Yukon. The Yukon has a small and underdeveloped economy which could develop and change markedly over the next thirty years. A broad agreement would better accommodate and encourage future

developments which cannot be foreseen at this time.

A reasonable free trade agreement should not seriously curtail the YTG in its efforts to diversify the Yukon economy, to support small business development and community development efforts, and to protect highly vulnerable renewable resource activities from overinvestment and too rapid development. Countervailing duties are -- or should be -- directed at export subsidies. In contrast, YTG and federal incentives in the Yukon are provided to offset the higher costs of doing business in the north, and the limited access of northern businesses to equity and loan capital. These types of programs should not be curtailed by a free trade agreement. The greater danger is that the federal government will use free trade as an excuse to reduce economic development programs, when the real reason is federal austerity. The cause of free trade is not helped when Ottawa and Washington mix up free trade issues with other critical issues: economic development programs for less developed regions; Canada's social programs and tax and regulatory environments; and the need to reduce the federal budget. These important policy issues should be addressed in their appropriate forums.

While free trade will threaten few if any existing jobs and businesses in the Yukon, the Territory's economy will still benefit from an extended transition period for implementing tariff reductions and other elements of a free trade agreement. An extended transition period (minimum of five years) will give the YTG time to implement its economic agenda and will give Yukon business people time to pursue import substitution opportunities with the full knowledge that expanded export markets will be available to them when their businesses are fully established.

As the recent trucking dispute with Alaska illustrates, the Yukon has an important stake in the type of dispute settlement system which is established. The system must be workable and as "non-political" as possible, and should

operate effectively not only in disputes between the two national governments, but also between states and provinces/territories.

Canada-U.S. free trade cannot be viewed as a threat to countries in the Pacific Rim and elsewhere which provide important markets for the Yukon and other Canadian producers. To the greatest extent possible, the free trade agreement should be consistent with the General Agreement for Tariffs and Trade (the GATT), should be trade creating rather than trade diverting, and should encourage participation by third countries in all or some of its components. In short, Canada - U.S. free trade should be viewed as a forward step in liberalizing international trade, not as the establishment of "Fortress North America".

Appendix B review previous studies that attempted to analyse the benefits and costs of free trade to the Canadian economy. To the extent that economic gains identified for the total country are realized in the Yukon, Canada-U.S. free trade could add between \$600 and \$1300 to the average per capita income of Yukon residents. The income gains could result from expanded Canadian production, improved productivity, higher real wages, and reductions in the tariff induced "subsidies" from the non-industrial to industrial areas of the country.

5.0 YUKON GOVERNMENT POSITION ON THE FREE TRADE NEGOTIATIONS

The Study Team has reviewed the literature regarding the benefits and costs of Canada - U.S. free trade to the Canadian economy (Appendix B). We find the arguments in favour of free trade quite persuasive. Seven arguments in particular carry significant weight.

1. Canada is virtually the only Western industrialized country without access to a market of 100 million people

or more, and therefore is the only Western country not enjoying the benefits of economies of scale, long production runs, and the product/market specializations which result from serving a large consumer market.

2. Protectionist sentiment is growing in the United States, and could dominate policy making under the next U.S. president after 1988. While many American concerns are not directed towards Canada, we could still be the major victim because of our high dependence on the U.S. market. A successful free trade negotiation could help the trade liberalization process, to the benefit of all U.S. trading partners.
3. As a consequence of the GATT negotiations of the past 20 years, Canadian trade barriers are no longer high enough to provide significant protection to Canadian industry. At the same time, the remaining American tariffs, when combined with actual or threatened non-tariff barriers in the U.S., are sufficient to prevent many investors from establishing plants in Canada to serve the full North American market.
4. Although Canada is the United States' largest trading partner, Canada accounts for less than 20% of U.S. external trade while the United States accounts for 70% of Canada's external trade. This trade imbalance holds the danger that the American government could implement protective trade measures harmful to Canadian interests and be relatively unaware of, or unconcerned by, the consequences for Canada.
5. Canada has recently emerged from the most difficult recession since the 1930's and our future economic prospects remain clouded by a number of developments: weak international commodity markets; slumping oil and gas prices; growing international concerns regarding the federal deficit; strong competition from newly

industrializing countries; and increasing demands for economic equity from other developing countries. Canada needs a strong challenge to move off "dead center" and prepare for the next century.

6. Canada has responded favourably to the substantial trade liberalization which has occurred since 1960. Since that year, Canadian manufactured end products have increased their share of Canadian exports from 8% to 42%. In short, as protection declined, Canadian manufacturing has become more, not less, internationally competitive. Past performance suggests that Canadian business people and workers will respond favourably to the new challenges posed by Canada-U.S. free trade.
7. The potential exists that other measures could be used to bring about the structural adjustments needed by the Canadian economy. These could include higher tariffs, non-tariff barriers, fiscal and tax measures, capital incentives to support research and development, and other policy initiatives needed to implement a Canadian industrial strategy. However, these measures have not been too successful in the past, and the current federal government does not have the funds -- and perhaps the political will -- to finance expensive new policy interventions and program initiatives.

In short, the Study Team believes the Macdonald Commission was correct as well as pragmatic in placing so much weight on Canada-U.S. free trade as a mechanism to improve the performance of the Canadian economy.

There are also many opponents to a Canada-U.S. free trade agreement. The most articulate opponents are the members of the labour movement. Their most serious concerns are:

- . the job losses which could result from a free trade agreement; the Ontario Federation of Labour has

developed estimates which suggest that up to 300,000 Ontario jobs would be lost; (in contrast, reports funded by the Ontario government suggest the adjustment costs to Ontario labour would be surprisingly small.)

- . growing dependence on the U.S. market and government and on American suppliers to satisfy Canadian consumer and industrial needs
- . free trade's negative effects on Canadian political and cultural sovereignty and on our ability to guide the future direction of the Canadian economy
- . the potential that free trade could undermine Canada's social welfare programs such as medicare and unemployment insurance, and could force Canada to adopt the same social policies and tax and regulatory environment as the United States in order to remain competitive with American producers.
- . the danger that free trade could remove the safeguards and other favorable provisions of the Canada-U.S. autopact.

In some respects, labour's position can be viewed as a plausible "worst case scenario" for Canada-U.S. free trade. The view of the DPA Study Team is that the Canadian economy is stronger and more resilient, and Canadian political independence is more firmly established, than the proponents of the worst-case scenario might suggest. At the same time, the risks and dangers posed by this scenario should be fully addressed in preparing the YTG position and the Canadian agenda for the free trade negotiations.

The fundamental concern of free trade opponents is that free trade is integral to the process through which the power of the market place is replacing national economic management and political will as the primary force driving the Canadian

economy. The labour movement and other opponents argue that a more desirable approach is to formulate and implement a Canadian industrial strategy. This alternative would include selectively raising tariff and non-tariff barriers as well as other policy and program interventions designed to strengthen Canadian industry, replace imports with Canadian production, reduce Canada's overall dependence on foreign trade, and diversify our trading partners. In reviewing this alternative, the YTG may wish to consider the following:

- . The only industrial strategy to be successfully implemented in Canada is Sir John A. MacDonald's National Policy of 1878. Most commentators agree this strategy benefited Central Canada at the expense of the Atlantic provinces, the West and the North.
- . A Canadian industrial strategy has been discussed, debated and negotiated at federal/provincial meetings and government/business/labour conferences for nearly two decades. Canada is a large federated state with major differences between regions and socioeconomic groups. The successful formulation and implementation of an industrial strategy would require broad consensus about Canadian economic objectives and the initiatives needed to achieve those objectives across different regions and groups. The emergence of this consensus appears no closer today than in the past.
- . Raising tariff and non-tariff barriers would be contrary to Canada's obligations under the GATT and would invite retaliation from our major trading partners.
- . Yukon possesses one-tenth of one percent of the Canadian population and one seat in the House of Commons. It is questionable whether Yukon interests would be better served by a situation where political decisions replace the market place as the primary force in guiding the destiny of the Canadian economy.

Previous analysis in Section 3.0 above has suggested that the Yukon has comparatively little to lose from free trade - except perhaps the placement of limitations on some future government initiatives - and could realize significant long term economic benefits related to freer and more secure access to the Alaska market of better than 500,00 people. Therefore, the Study Team proposes that the Yukon government support the start of negotiations with the United States on free trade, and that the YTG be prepared to provide qualified support to a free trade agreement. The support would be qualified in the sense that Yukon approval would be conditional upon certain requirements being met in the final agreement. These requirements are as follows:

1. The agreement should be broad in scope and should address tariff and non-tariff barriers, as well as trade in both goods and services.
2. The agreement should be open to participation from other countries and should not pose a threat - or be perceived as a threat - to third countries (especially in the Pacific Rim).
3. The free trade arrangement should be fully consistent with the letter and spirit of Article XXIV of the General Agreement on Tariffs and Trade and should not jeopardize Canada's international trading relationships and responsibilities.
4. The dispute settlement mechanism should be workable not only at the level of the two national governments but also in resolving disputes between states and provinces/territories.
5. The transition period for implementing the arrangement in Canada should be no less than five years and should be significantly longer (by five years or more) than the American adjustment period.

6. The free trade agreement should in no way compromise Canada's social programs, or the ability of federal, provincial and territorial governments to provide economic development assistance to less developed regions (particularly the north) and to less advantaged groups (particularly Native people).
7. Northern benefits packages and northern tax exemptions and credits should not be affected by a free trade agreement.
8. Canadian investment policies resulting either directly or indirectly from the agreement should facilitate access to the foreign investment needed for Yukon development, but should also allow the YTG to protect vulnerable industries (such as trapping and outfitting) from overinvestment and too rapid development.
9. The federal government should provide support to the improvements in transportation and communication systems needed to ensure that Yukon businesses and residents receive the greatest benefit possible from a successful free trade negotiation.

If the free trade negotiation moves in a direction which is unfavourable to these concerns, the YTG should reserve the right to withdraw its support for the negotiation and agreement. The Study Team is proposing the YTG take a positive stance because:

1. We believe free trade is in the long term economic interests of the Yukon as well as Canada.
2. We believe Yukon concerns have a better chance of being addressed if the YTG offers overall support to the free trade initiative.

If the Yukon were to oppose free trade, the YTG would stand well behind Ontario, the Canadian Labour Congress, the footwear, clothing and textile industries, and other powerful groups which hold legitimate and well recognized interests and concerns. The federal government will be looking for friends around the conference table and may be more willing to listen to the concerns of a supporter (no matter how small its population).

In finalizing its negotiating position on free trade, the YTG may wish to consider holding meetings with three groups.

- . Meetings with the Alaska and NWT governments could be used to identify areas of common interest and concern among the three northern jurisdictions. One purpose of the meeting will be to display to Alaska the YTG view that free trade is to the mutual benefit of both the American and Canadian parts of northern North America. Because of the importance of First Ministers Conferences in Canada combined with the Yukon's common border with the other two jurisdictions, the YTG may be in the best position to put forward issues of common concern to all three northern jurisdictions.
- . The YTG should meet with the British Columbia government to discuss areas of common interest, in particular B.C.'s views on the possible responses of the Pacific Rim countries. Like the Yukon, the B.C. economy could be hurt badly if Pacific Rim countries retaliated against Canada - U.S. free trade. The Yukon and B.C. governments could explore the development of a common position on this and other issues.
- . The YTG should discuss with the NWT and the less developed provinces (e.g. the Atlantic provinces and perhaps Manitoba and Saskatchewan) the potential for a common position on regional development issues and programs and on economic development programs for less

advantaged groups. The possibility exists that free trade could be used as a lever to reduce business incentives in the more industrialized regions of Canada and thereby enhance the relative effectiveness of the remaining development programs in less developed areas.

The final issue is when the Yukon government should express its qualified support to Canada-U.S. free trade and the conditions attached to that support. The DPA Study Team has not been attending the federal/provincial meetings on free trade and therefore finds it difficult to identify a precise time for outlining the YTG position. The Team's view however is that an earlier statement could offer advantages. An earlier statement may allow the YTG to have greater influence on the federal government's agenda for the free trade negotiation. If the YTG waits until the Canadian negotiating position has been finalized and announced, it may be too late to have any impact on the free trade agenda.

PEOPLE INTERVIEWED FOR THIS STUDY

Person	Agency
Rob McWilliam	YTG Economic Development
Shakir Alwarid	YTG Economic Development
Tony Penikett	YTG Government Leader
Alan Hunt	YTG Economic Development
Dick Filteau	YTG Agriculture
David Skidd	YTG Intergovernmental Relations
Russ Graham	Ex-YTG Tourism
Terry Sewell	YTG Community and Transportation Services
Lindsay Staples	YTG Executive Council
Mark Hoffman	YTG Renewable Resources
George Lerchs	DRIE
Larry Bagnell	DRIE
Colin Heartwell	Northern Affairs - INAC
Duncan Knowler	Northern Affairs - INAC
Al Schott	External Affairs, Seattle
Tony Gonda	Yukon Native Products
Elmer Fast	DFO
Marilyn King	Association of Yukon Communities
April Neave	Yukon Chamber of Commerce
Bill Dunbar	Yukon Chamber of Commerce
Fred Peschke	Whitehorse Accountant involved with Yukon Forest Industry Association
Judy Gingell	Yukon Indian Development Corp.
Ion Christiansen	Vice-Chairperson of Yukon Economic Council
Dennis Prince	Chamber of Mines
Ralph Zaccarilli	Yukon Federation of Labour
Bill Weigand	Designers North
Ilse Wohlforth	Independent Meat Products
Bill Bowie	Arctic Inland Resources
Anne Steinge	Gray Mountain Pottery
Clyde Boyd	Irlybird Industires
Frank Wilcox	Lubbock Farms
Jack Hogan	General Enterprises
Elaine Kozak,	B.C. Ministry of International Trade and Investment
Michael Grist	Alaska Department of Labour
Chris Miller	Alaska Economics Inc.
David Reaume	

APPENDIX A

**WORKING PAPER ON SECTOR
IMPACTS AND FREE TRADE ISSUES**

1.0 INTRODUCTION

The purpose of this Appendix is to bring together information from a wide range of sources in order to assess the possible opportunities and risks of Canada-US free trade from the perspective of different economic sectors and socioeconomic groups within Yukon. The paper also briefly assesses free trade in terms of various issues raised in the literature and by people interviewed during this assignment. The sources used in this analysis are indicated in the Bibliography. Many readers will be familiar with the material included here. The Appendix in part operates as a working paper for the DPA Study Team in order to assemble and integrate information from a variety of sources and to assess this data within the context of a Canada-US free trade negotiation and agreement.

2.0 SECTORAL ANALYSIS

Agriculture

Current Status and Potential. The Yukon agricultural sector is very small and undeveloped. In 1984, about 4100 hectares of land in Yukon were devoted to agriculture - mostly forage production to feed livestock - and the 1981 Census reported 24 Census farms with a total area of 719 hectares.

The Territory has some agricultural potential. Yukon's climate is moderate compared with most of Canada's north, and cool season vegetables, certain fruits, forage crops, oats and barley can be grown successfully where soil conditions are also favourable. About 630 sq.km of potentially arable land occur along the valleys of the Stewart, Pelly, Yukon and Liard Rivers.

In 1985, the Agricultural Products Act was passed by the Yukon Legislature. The Act opens the door for Yukon producers of eggs, poultry and red meat to sell to retailers to meet local demand. There is also some discussion of establishing a farmer's market in Whitehorse.

Our respondents suggested the agricultural sub-sectors holding greatest potential include:

- . Potatoes and other vegetables. Yukon is currently importing food valued at about \$40 M from the south - about 12-15% of these imports are fresh vegetables. One informant suggested Yukon producers could capture a local market of perhaps \$2 M.
- . Dairy, eggs and other poultry. The market for local egg production was estimated at \$750,000.
- . Grass production for hay which is estimated to be a one million dollar market. Grass is currently imported each year from the Peace River at fairly high transportation costs.

- . Longer-term opportunities for the red meat industry (beef and pork) and perhaps for wild animals (e.g., elk and reindeer).

A related opportunity is to provide fresh produce, dairy products, eggs and bakery products to tourists passing through or staying in Yukon.

Opportunities. The potential benefits to agriculture from free trade are quite speculative at this time and likely quite small relative to the total Yukon economy. The benefits could result less from the lowering of tariffs (which typically are low or zero on unprocessed agricultural products -- plants are an important exception with tariffs of 7-8%) and more from the simplification of customs procedures and changes to transportation/wholesale/ distribution systems. Because of the high incomes in Alaska, free trade could open up opportunities for specialty food products, both processed and unprocessed (e.g., bean sprouts). Changes in distribution systems -- which would see the development of the Skagway-Whitehorse-Beaufort transportation corridor -- could provide opportunities for Yukon producers to ship down to South East Alaska and up the Dempster to Inuvik and other Beaufort communities. Alaska could provide lower priced barley and wheat to supply the Yukon livestock industry. Free trade alone, however, will not develop these opportunities. Work is also needed on establishing marketing and distribution systems.

Risks. The risks are just as speculative as the benefits. The potential exists that free trade will result in lower priced imports either through import of wheat, vegetables and dairy products from the Delta Junction, or through improved and more direct transportation connections with US suppliers in the lower 48 states. These outcomes would lower prices to consumers but might limit future opportunities for Yukon producers. However, respondents suggest that the threat from Alaska may be slight. Because of the state's larger land base, Alaska producers appear to be emphasizing larger more land-extensive forms of production in the areas of barley, early wheat and livestock. The potential exists therefore that the Yukon and Alaskan agricultural sectors could be developing along complementary rather than competitive paths, with Yukon focussing on smaller-scale production and specialty products. In addition, because of the high wages and costs in Alaska and the low value of the Canadian dollar, Alaskan food prices currently appear to be significantly above Yukon prices. (However, with the end of the Alaskan boom and possible future strengthening of the Canadian dollar, this price advantage could be transitory).

Concluding Comment. On balance the benefits of free-trade would be greater than the risks for the agricultural sector, but the net effect will likely be small compared especially to the overall Yukon economy. The generation of any benefits

will require supporting actions in related areas (e.g., marketing and distribution). The information base is not adequate to support firmer conclusions. The lack of information suggests that market opportunities in Alaska and potential competition from Alaskan producers under the current trade system and under free trade be included in the terms of reference for future feasibility and related studies on Yukon agricultural opportunities.

Forestry

Current Status and Potential. In 1985-86, the total value of production of the Yukon forest products industry was about \$5 million. Much of the lumber production is used locally by the construction industry. The retail market, such as lumber sales to homeowners renovating their homes, is also important, as are lumber sales to the mining industry and firewood production which amounts to 40% of total production.

One major problem is that only 40-50% of the tree is used for lumber. Markets need to be found for wood chips. Possibilities include using wood chips as a replacement for oil in heating schools and other public buildings (wood chips are being tested at a school in Pelly), and supplying Yukon chips to pulp mills in northern BC.

There are about 25 sawmill operators in Yukon. The largest is Watson Lake Forest Products Ltd. (WLFP) which accounts for nearly one-half of Yukon's forest product output and is the only operation with a dry-kiln. Nearly all of the remaining producers are family-type operations with 2-4 employees; virtually all of them are operating close to the margin and have no funds for modernization and marketing. The Yukon Bureau of Statistics reported 42 full-time employees in the forestry sector in 1984.

One informant emphasized the forestry resource is badly under-utilized. The present cut amounts to less than 5% of the total annual allowable cut. Yukon has 219,000 sq. km. of forest in total (41% of the land area), but only 67,000 sq. km. is able to produce a merchantable forest crop within a reasonable period of time, and only 23,000 sq. km. of this area is accessible at present. The EDA is currently funding a study for the Yukon Forest Industries Association to assess the potential of the Yukon forest industry from a business perspective.

Opportunities. Logs and lumber currently enter the United States free of duty. One informant suggested that the largest 2-3 Yukon operators are already shipping a significant proportion of their production into Alaska. It is estimated that 45% of Yukon's lumber production is normally exported to the state. Fuelwood is also being shipped there and wood chips would also offer potential.

One respondent noted there is not a great deal of timber in Alaska north of Anchorage. Northern Alaska, therefore, could

be readily supplied via the Alaska Highway. The potential may exist, therefore, for Yukon operators to promote market niches in specific geographic areas and specific products in the state.

However, it was suggested the federal government would be reluctant to strongly encourage the development of the Yukon forest industry - especially if development would result in expanded Alaskan sales - until the dispute regarding BC lumber sales to the United States is fully resolved. Full resolution may occur only as part of a free-trade agreement. Accordingly, full federal support to Yukon forest development and secure access to the Alaska market could be two important benefits from a free-trade negotiation. Looking ahead, dropping tariffs on more processed products could expand the longer-term potential for production of pulp, paper board, waferboard, plywood, and perhaps some specialized types of furniture. Current US tariffs on these products are generally in the 2-4% range but a few tariffs are much higher. As well, operators making small shipments could benefit from simplifying US customs procedures, and all operators would benefit from reduced prices for machinery, equipment and other production inputs (resulting from the removal of tariffs).

Risks. One informant indicated he was not aware of any Alaskan forest products entering the Yukon. He believed this reflected the high wages and production costs in Alaska and the state's limited resource base relative to its high demand. Other respondents suggested that Alaska is more interested in the large markets of the Pacific Rim rather than the very limited market offered by Yukon. A significant portion of Alaskan forest products output is shipped to Pacific Rim markets. Alaskan exports of forest products totalled \$U.S. 219 M in 1984.

Concluding Comment. Yukon operators could benefit significantly from secure access to the Alaska market and from reduced tariffs on more finished wood products. However, both types of benefits are longer-term in nature, especially the second one, and are strongly dependent on the maintenance of current relationships between Alaskan costs and the value of the Canadian dollar.

Hunting and Trapping

Current Status and Potential. The value of fur production is expected to total \$1 M in 1985, while the value of meat from wildlife harvesting was estimated at about \$1.6 M in the 1980-81 season. Both estimates probably significantly understate the cash and non-monetary value of renewable resource harvesting activities to participants, most of whom are native people. The general consensus is that hunting and trapping have been neglected in the past and, therefore, both sectors are operating at well below their potential. The renewable resource harvesting activities are being addressed in the Renewable Resources Subsidiary Agreement under the EDA.

Opportunities and Risks. Both the opportunities and the risks of free trade would appear to be minor. Hunters and trappers will benefit from low cost supplies, and trapping could benefit from any increases in shipments of specialty goods which include wild fur. Expanded export sales of Yukon Native Products and similar operations could provide attractive alternative markets for Yukon trappers. One area of concern is that customs procedures and officers have been used to control imports and exports of products using rare and endangered species. At times, these procedures have been used to restrict trade. At the same time, some alternative to these procedures will need to be found. Yukoners, either Native or non-Native, are not allowed to hunt and trap in Alaska, and Alaskans are not allowed to hunt and trap in Yukon. It is possible -- although not likely -- that cross-border hunting and trapping could emerge as an issue from either side in a free trade negotiation. In light of Yukon's limited land base and resources and the large Alaskan population, it is questionable if changes to these regulations would be to Yukon's benefit.

Commercial and Subsistence Fishing

Current Status and Potential. The commercial catch in 1985 consisted of about 12,600 chinook and 35,600 chum salmon with a landed value of about \$150,000. The wholesale value would be somewhat greater. All of these were record levels. There are about 40 fishermen licenced to fish the Yukon - about 25 are active in any given year - plus two other fishermen who fish the Taku River in northern B.C. As well, about 35-40 Yukon residents hold freshwater licences. Ten lakes, mainly in the Southern Lakes area, are designated for freshwater fishing. The quota totals 100,000 pounds but less than 10,000 pounds are caught in a typical year. The freshwater fish, mainly lake trout and whitefish, are sold on the local market. Finally, the native subsistence salmon fishery was estimated to be worth about \$700,000 in 1982.

The Yukon salmon fishery is reported to be operating at well below potential in the sense that only 7 - 8% of the fish spawned in the Canadian waters of the Yukon River are caught by Yukon fishermen. It is hoped that the successful resolution of the International Pacific Salmon Treaty will provide a catalyst for increased production of Yukon's commercial fishing industry. The Canadian draft of the Amendments to the Pacific Salmon Treaty calls for two-fold increases in the Yukon's share of the total allowable catch in the chum and chinook fisheries. One respondent noted as well that the export of fresh sockeye and pink to the United States is prohibited by Canada. This ban prevents Yukon fishermen fishing the Taku River from having access to the lucrative market in Alaska. Alaska offers a large market for fresh sockeye but not for chinook and chum.

Opportunities and Risks. There are no tariffs on fish exports to Alaska or the lower 48 states. For this and other reasons, the benefits from free trade would be miniscule compared to the successful resolution of the salmon treaty amendment negotiations. However, the following impacts could be of some importance:

- . Fishermen should enjoy lower-priced supplies.
- . Simplified customs procedures could encourage exports of small shipments of fresh and frozen salmon, freshwater fish, and more processed products (eg., smoked salmon) to Alaska and the lower 48 states.
- . The possibility exists that the ban on exports of fresh sockeye and pink could be removed. This would benefit Yukon fishermen while hurting Northwest B.C. processors.

In general however, the major constraint to fishery development in the Yukon is resource access, not market access. There is the possibility that the salmon treaty amendment negotiations would become linked to the free-trade negotiations. It is arguable however whether this linkage would be in the Yukon's interest.

Mining

Current Status and Potential. As is well known, the last few years have been a difficult period for the Yukon mining industry. From 1980 to 1984, the aggregate value of mineral production fell from \$360 M in 1980 to about \$57 M in both 1984 and 1985, and mining employment decreased from an average of 1500 workers through 1981 to an average of about 500 workers through the first three quarters of 1985. In 1985, Yukon's mineral production consisted almost entirely of precious metals - gold and silver. Gold production, mostly from placer mines, amounted to about two-thirds of the 1985 production. The Yukon's only significant hard rock mining operation was United Keno Hill which mined their high grade silver deposit at a modest daily rate of 300 tons. Several small high grade silver operations were operated on Keno Hill and in the Hess River area. Spending on exploration activity, mainly on precious metals, was estimated to be in the range of \$20-\$30 M in 1985.

The drop in mineral production and employment is largely explained by the full closure of the Cyprus-Anvil lead-zinc mine at Faro at the end of 1982. A smaller factor was the closure of the Yukon's only copper mine, Whitehorse Copper, in the same year. In October 1985, a loan agreement was signed between Curragh Resources Corporation, the new owner of the Cyprus-Anvil mine, and the governments of the Yukon and Canada to set the stage for the re-opening of the Anvil mine. YTG forecasts suggest that full start-up of the mine by the Summer of 1986 would add about \$150 M to Yukon mineral production in 1987 and would add almost 600 jobs to Yukon

mining employment. Reopening the mine has been held up pending an agreement between the Alaska and Yukon governments on completion of year-round road access to the port of Skagway. However, we were told that the agreement on road development will be announced in April 1986.

The Yukon has numerous other mineral deposits scattered throughout much of the Territory, including lead, zinc, gold, silver, copper, iron ore, asbestos, barite, molybdenum and tungsten. There are extensive coal deposits in the Bonnet Plume area, and smaller coal deposits elsewhere. A DIAND study dated November 1983 indicated the following deposits are among the most likely new producers over the medium to long term:

1. Hudson Bay Mining and Smelting Co. Ltd.'s "Tom" lead-zinc-silver property in the Macmillan Pass area on the Yukon-Northwest Territories border.
2. The lead-zinc deposits in Howard's Pass, owned by Placer Development Ltd. and Cygnus Mines Ltd.
3. Amax of Canada Ltd.'s "Mactung" tungsten property, also in the Macmillan Pass area.
4. The "Grum" and "Vangorda" lead-zinc-silver deposits under Cyprus Anvil ownership, near the company's present operation at Faro.

More recent studies suggest there are good prospects for Canamax's Ketya River gold find (south of Ross River) coming into production, and that the Antoniuk gold deposit on Mt. Freegold also appears to hold promise. The latter deposit is about 40 km. from Carmacks.

The key factors which influence the outlook for the production of minerals in the Yukon are metal prices, the value of the Canadian dollar vis a vis the U.S. dollar, the ability of Curragh Resources to begin and maintain production, and the application of new mining technologies. Current Canadian policy is to allow market forces to determine which deposits are developed. The policy is based on the view that regional development strategies should not encourage mineral developments that are not economically sound, as these would be detrimental to Canada's international competitive position.

Opportunities. The most immediate benefit from free-trade will be from the lower prices on inputs purchased from the south and the United States. Purchased non-labour inputs constitute between 30 and 40% of the total sales (gross revenues) of the typical metal mine in Canada. Average tariffs on inputs used by the mining industry range from about 2 to 5%, depending on the expense category. Prices in the Yukon could decline even further as a consequence of simpler customs procedures and the development of more efficient transportation and distribution systems. A drop of

5% in the cost of purchased inputs would improve the returns to sales by up to 2%, and would provide much greater improvements to the returns to capital and investors' equity. These cost decreases would make existing and future mines more profitable and might allow some properties to be developed sooner than would otherwise be the case.

As well, the Yukon mining industry is very concerned about rising protectionism in the U.S. and its potential effects on current and future mineral production in the Yukon. All Yukon precious metals are shipped to the United States' market and the U.S. market could be important to the development of base metal properties in the future. The industry therefore supports a free-trade agreement because it would guarantee access to the American market.

Looking at the very long term, free-trade may marginally improve the prospects for potential smelting and refining of the Yukon's non-ferrous base metals. However, U.S. tariffs on non-ferrous metals are currently very low - less than 1% - and therefore the major impact of a successful free-trade negotiation would be to guarantee access to the U.S. market for non-ferrous metals. Any benefits from better access are highly speculative and lie many years into the future.

Risks. The greatest risk identified by respondents is that Pacific Rim countries may respond negatively to U.S.-Canada free-trade (viewing free-trade as Fortress North America) and could retaliate by raising barriers to Yukon exports of lead, zinc, and other metals and commodities. Other arguments suggest that the likelihood of Pacific Rim retaliation is not high. Japan, Korea and other Pacific Rim countries buy from Canada because of our competitive prices and security of supply. Free trade will not alter this situation - in fact, Canadian commodity prices could be somewhat more attractive (see above). The Japanese in particular like to purchase from as many countries as possible in order to trade-off one supplier against another in bargaining for the lowest possible price. Retaliation could diminish this capability and would increase Pacific Rim dependence on third world suppliers which are less dependable than Canada. Finally, Japan and other Pacific Rim countries could benefit from a Canada-U.S. free-trade negotiation to the extent that the negotiation shifts the trade agenda in Washington from a protectionist focus to a more free-trade stance.

Japanese political leaders to date have provided cautious support to the negotiation, suggesting Japan may recognize this potential benefit.

Concluding Comment. Through lowering costs and guaranteeing access to the U.S. market, free-trade could provide significant benefits to the Yukon mining industry. For this reason, the Yukon Chamber of Mines and the Klondike Placer Miners Association strongly support free-trade with the United States. The threat of retaliation from the Pacific Rim may not be great but the risk should still be taken

seriously because of the consequences of error for the Yukon economy and other parts of Canada. This means that both the negotiation and the agreement should be fully consistent with the letter and the spirit of Article XXIV of the GATT (General Agreement for Tariffs and Trade). This article is based on the view that a free-trade agreement to the greatest extent possible should be designed to create trade with third countries, rather than diverting trade from third countries. Moreover, Japan and other Pacific Rim countries should be invited to participate in all or parts of the free-trade agreement (eg., protocols regarding services, non-tariff barriers, or dispute settlement mechanisms).

Oil, Gas and Other Energy Sources

Except for the generation of electricity, no energy is produced within the borders of the Yukon Territory. The Kotaneelee gas field in the extreme southeast corner of the Territory provided the Yukon's only producing gas well before production was suspended in December 1980. Gas from this well and from the Pointed Mountain gas field nearby in the NWT was transported through the Westcoast Transmission system to B.C. and American markets. Oil and gas have also been discovered in the Eagle Plain area in the Dempster Highway corridor near the NWT border but not in quantities which would justify pipeline construction. Production would appear to depend on the construction of the Dempster Lateral from the Beaufort which would allow Eagle Plain gas to be transported to Whitehorse. There has been very little exploration for oil and gas in the Yukon in recent years. The Yukon also possesses extensive coal deposits in the Bonnet Plume area, and smaller coal deposits elsewhere.

Yukoners have also benefited from oil and gas exploration activity in the Beaufort Sea, although most would agree the benefits have been below expectations and potential. Economic benefits in 1985 included:

- an estimated \$14 M in increased sales for Yukon businesses;
- employment of about 115 - 120 Yukoners by exploration companies in the Beaufort Sea; their wages totalled about four million dollars in 1985;
- increased use of the Dempster Highway as a transportation link to the Arctic Ocean;
- development of barite deposits (barite is used to make drilling mud).

Exploration activity in the Beaufort is expected to decline for at least the next 2 - 3 years because of the completion of existing exploration agreements, the end of the PIP grants of the federal government, and the dramatic decline in the international prices of oil and gas.

Opportunities and Risks. The development of the Yukon's energy resources and a decision to proceed with Beaufort production will depend on energy prices and the availability of secure markets. Free-trade with the United States will have little influence on these decisions, except perhaps indirectly through removing irritants in Canada - U.S. trade relations and thereby better securing long term access to U.S. energy markets. Free-trade, through altering transportation/distribution systems, could enhance the Yukon's ability to benefit from the construction and related activity resulting from a decision to proceed with Beaufort production. This potential is further explored in the section on transportation and distribution. As well, reduced tariffs on goods and reduced non-tariff barriers on goods and services could allow Yukon-based companies to better compete for contracts on the Alaskan North Slope. (North Slope business could be small for the near term but dramatic upward shifts in international oil and gas prices could change the situation virtually overnight (as has happened twice in the last fifteen years).) The YTG is currently investigating the potential Alaskan market for Yukon oil and gas supply companies as part of a separate study.

The only apparent risk is that if Yukon oil and gas resources are developed at some point in the future, Alaska-based oil and gas supply companies will be in a better position under free trade to compete for Yukon business.

Tourism

Current Status and Potential. The YTG estimates that total visitor expenditures for 1985 were about \$86 M, which represents a 6% increase over the 1984 value, and that border crossings approached 44,700. In 1984, visitors from the U.S. constituted 61% of total summer visitors, visitors from other parts of Canada made up 30%, and offshore markets comprised the remainder. Eighty-six percent of visitors came by highway. With the decline in the mining industry, tourism in recent years has been the second most important industry in the Yukon after government.

Reports indicate that tourism can be an important source of growth to the Yukon economy over the longer term but that significant improvements are needed in this sector. These include infrastructure improvements (eg., accommodation) and developing alternative themes to the Klondike in order to penetrate new markets. Major thrusts are to increase the spending and length of stay of tourists passing through the Yukon on their way to Alaska, and of tour groups from cruise ships landing at Skagway and travelling by bus to Whitehorse. In May 1985, a \$10 M Tourism Sub-Agreement to the Canada/Yukon Economic Development Agreement was signed by the Yukon and federal governments. These funds are being used to stimulate the tourism industry through various tourism development projects and marketing initiatives over the next five years.

Opportunities. There are virtually no trade barriers which directly affect the Yukon tourism sector. Nonetheless, tourism in the Yukon could benefit in a number of ways.

1. The costs of purchased (non-wage) goods and services would decrease, thereby improving the profitability of tourism operations and increasing the attractiveness of Yukon destinations relative to Alaska locations. For some operations, the impact on costs and profitability would be quite substantial. Purchased goods and services can account for 30% or more of the total sales of accommodation facilities, and 50% or more of the sales of restaurants and lounges. A 5% decrease in these costs would have a measureable effect on returns on sales and investment.
2. Free-trade can be expected to increase the two-way flow of goods, services, and people between the Yukon and Alaska. Any resulting improvements in communication and transportation connections (eg., more flights) should increase the number of business and pleasure travellers from Alaska.
3. Closer business links with Alaska (and perhaps the lower 48 states) should mean expanded interest in Yukon investment opportunities. Alaskan firms have already invested quite heavily in the Yukon tourism sector. Future growth in Yukon tourism will require more investment capital than Yukon sources can be expected to generate.
4. Yukon tourism operations at times are hindered in their U.S. promotion because of problems in taking brochures, displays, etc. across the border. Free-trade would remove most of these irritants.

Risks. Free-trade with the United States will mean that Canadian tourists passing through the Yukon to Alaska will no longer be limited in the dollar value of duty-free purchases which can be made in Alaska. This could reduce per capita expenditures in the Yukon, especially if a stronger Canadian dollar should remove the price advantages (in U.S. dollars) now enjoyed by Yukon businesses.

Some Yukon residents may also be concerned that free-trade could increase Alaska ownership and control of the Yukon tourist sector and economy. American companies already have a strong presence in the Yukon. The four major tour companies are American-owned. Greater vertical integration (eg., American tour companies operating hotels) could make it difficult for smaller operators. This is the negative side of point three above.

A more general concern is that expanded tourism (from whatever source) will place further pressure on Yukon's limited wildlife and sport fishing resources, will detract from the wilderness experience offered by current guides

and outfitters in Yukon, and will conflict with the recreation activities of Yukon residents. Viewed from this perspective, tourism development should emphasize non-consumptive and non-conflicting uses of Yukon resources.

Concluding Comment. Tourism will not be directly affected by a free trade arrangement with the United States, but the indirect effects on balance should be positive (unless growing Alaskan investment is seen by the majority of Yukoners as a negative development).

Manufacturing

Current Status and Potential. The Yukon manufacturing sector is very small. It is comprised largely of small, cottage-type establishments serving the local market or producing handicrafts or other specialty items for either the local market, tourists, or small-scale export. Manufacturing employment is reported by different sources to be between 100 and 300, and the 1985/86 Yukon Business Directory reported the following distribution of manufacturing establishments by broad industry category:

	No. of Establishments
Chemical manufacturing	1
Clothing manufacturing	3
Fabricated metal manufacturing	9
Fibreglass product manufacturing	1
Food manufacturing	8
Furniture and fixtures	4
Leather and allied products	1
Non-metal manufacturing	10
Printing and publishing	18
Rubber products	1
Textiles	1
Transportation equipment	2
Wood manufacturing	29
Manufacturing - other	16

The listings suggest that manufacturing is the principal activity of perhaps less than one-half of these establishments. As well, some firms are listed under more than one manufacturing category.

Opportunities. Yukon manufacturers of specialty items would benefit from better access to markets in Alaska and the lower 48 states, as well as from the greater two-way flow of business and pleasure travellers which could result indirectly from free-trade. Examples of manufactured products currently produced in the Yukon which either are being exported or could be exported include:

- Yukon parkas - Yukon Native Products
- Jewelry - Designers North
- Fibreglass tanks - Yukon Fibreglass
- Log houses - Mikkelson Construction

Prefab houses - Denaka Construction
 Timber products - Watson Lake Forest Products, Ten Mile
 Logging, Arctic Island, and others
 Pottery - Grey Mountain Pottery
 Salmon - Han Fisheries, Klondike Fisheries, Ice House
 Baked goods and products

Many of these manufacturers are facing fairly high tariffs - ranging perhaps from 5% to 40% - in exporting to the United States. Perhaps more important, U.S. customs procedures can be a serious impediment to export sales of small shipments from Yukon cottage industries. Completing the U.S. customs paperwork can take considerable time and effort, and U.S. customs offices at border points are often closed during the winter months. Most customs brokers are in Anchorage and charge a minimum of \$150 U.S. per shipment, regardless of its value. The brokerage fee means shipments of less than \$1000 are not feasible. These factors (combined with the very poor mail service between the Yukon and Alaska) largely prevent small shipments by mail to Southeast Alaska (a natural market for Yukon specialty manufacturers). Simplifying customs procedures would greatly facilitate test marketing and small shipments by mail to Alaskan customers as well as markets in the lower 48 states. Greater standardization in packaging and labelling would also assist export sales of smaller manufacturers.

Yukon manufacturers will also benefit from lower prices on manufactured inputs. One respondent noted that purchased inputs accounted for about 20% of gross sales. A decrease of 5% in the cost of purchased inputs -- this is the average (weighted) Canadian tariff on manufactured imports -- from the United States would mean a 1% increase in the return on sales, and of course, a much higher impact on the return on investment. Finally, small-scale specialty manufacturers would benefit significantly from improvements in transportation and communication links between the Yukon and Alaska which would be a direct result of Canada-U.S. free trade.

To date, Yukon producers have not found a great deal of competition from Alaskans in the areas of arts and crafts and specialty manufactured items. Yukon producers at the present time could hold a comparative advantage in the production of specialty items (although as argued below, this situation could change quite quickly).

Risks. Free-trade should also mean expanded competition from Alaskan manufacturers in the Yukon market. The Alaskan manufacturing sector is much larger than industry in the Yukon. Most recent estimates indicate that there are about 14,000 manufacturing employees in Alaska (about 7% of Alaska's total work force and at least 45 times more employees than in the Yukon manufacturing sector). Alaskan manufacturers to date have not been active in the Yukon market. Five reasons can be offered for this:

1. The small size of the Yukon market.
2. Alaska's emphasis on the Pacific Rim in their export promotion efforts.
3. The scale of the Alaskan boom which made it very difficult for local manufacturers just to keep up with local demands.
4. High Alaskan costs, the low value of the Canadian dollar, and Canadian trade barriers which in combination made Alaskan goods uncompetitive in the Yukon market.
5. Limited Alaskan production of specialty items and consumer goods (three quarters of Alaskan manufacturing is in sawmilling, pulp and paper, and fish products)

It would be a mistake to assume that all of these factors will continue for the foreseeable future. The Alaskan boom has come to an end, which should result in lower Alaskan costs and prices, and greater interest in alternative markets and economic diversification. The Canadian dollar could strengthen in the future, and of course free-trade will mean no tariffs and reductions in other barriers between our two countries. Unfortunately, Yukon business people and the Yukon government know very little about the Alaska market and about actual and potential Alaskan competitors in a free-trade situation.

Concluding Comment. Yukon manufacturers could benefit significantly from a free-trade arrangement but the risk of expanded Alaskan competition cannot be ignored. This risk can be reduced only through better information on the Alaskan market and potential competitors located in the state. This information is essential to identifying the right product and market niches in the Yukon's import substitution efforts and in promoting exports of specialty items.

Construction

Current Status and Potential. In more normal times, construction firms are an important employer in the Yukon economy. In the third quarter of 1985, construction employment of 482 constituted about 5% of total full-time employment in the Yukon. Construction employment has declined from a peak of 663 in the third quarter of 1981. The 1985/86 Yukon Business Directory listed about 60 construction and construction-related companies in the Yukon, and many more firms involved in the construction trades.

Opportunities and Risks. The effects of free trade will likely not be too great in either direction. The relaxation of non-tariff barriers could allow Yukon-based construction contractors to more readily compete for government and non-government work in Alaska, and could facilitate the establishment of joint ventures with Alaskan companies to compete for work in either location. Free trade also will

facilitate the movement of equipment back and forth across the border. American regulations are a problem at this time. As well, free trade will increase the ability of Alaskan contractors to compete for Yukon work. The strong Alaskan economy, high Alaska costs, the low value of the Canadian dollar, and the small size of the Yukon construction market could suggest that Alaskan contractors may not be competitive or interested in Yukon work. However, economic conditions of the past half decade may not prevail over the next ten years. With reductions in the Alaska construction market, Alaskan contractors can be expected to respond by paying lower wages, paying less for supplies, and reducing margins. There is evidence this process is already starting to occur.

In recent years, the economic cycles in Alaska and the Yukon have not been operating in tandem. Since 1980, the Alaskan economy has continued to expand strongly at a time when the Yukon economy has been in the worst downturn since the 1930s. To the extent this occurs in the future, free trade may tend to dampen the fluctuations in this highly cyclical industry (and the two economies in general) by better allowing Yukon contractors to compete in Alaska when the Yukon market is weak, and vice versa.

Even after free-trade, there may continue to be non-trade barriers which will restrict the ability of Yukon and Alaskan contractors to compete in each other's markets. Construction for the most part is a local market-oriented industry, because of the need to know about local conditions, by-laws, regulations and standards. As well, immigration restrictions will still be in place, albeit perhaps in a modified form. Free-trade may allow professional and highly-skilled workers to work across the border on a temporary or perhaps semi-permanent basis, but, with one exception, it is questionable if entire work crews will be able to cross the border. In this regard, Native-owned and operated construction companies could be at an advantage. Under the Jay treaty, Native workers in the Yukon and Alaska can easily acquire a permit which allows them to work on the other side of the border.

With the possible exception of Native companies, free-trade will likely have greater effects on inter-country trade in construction technologies, skills and expertise, and on transfers of financial capital, than on direct trade in construction services and transfers of work crews. Similar situations will likely prevail for other services which typically are closely tied to local markets. A few Yukon construction companies have already established fully owned subsidiaries in Alaska. These subsidiaries have been successful in competing for Alaskan business. One interviewee noted however that banks and insurance companies in Whitehorse lack the expertise to support cross-border business transactions.

Transportation, Wholesale and Distribution

Current Status and Potential. Transportation industries employ a higher percentage of the Yukon labour force than elsewhere in Canada, since most goods consumed in the Yukon are imported; as well, the shipment of mineral concentrates out of the Territory has normally employed hundreds of Yukoners. In the third quarter of 1985, the transportation sector accounted for about 4% of full-time employment in the Yukon. The 1985/86 Yukon Business Directory indicated the following regarding the number of firms active in two transportation and distribution sub-sectors:

	Number*
Transportation, Storage & Warehousing	100
Wholesale	25

*Transportation and wholesale is not the principal activity of all of these firms.

Statistics Canada data indicates that for the last year available (1979), Yukon wholesalers relied twice as much for their supplies on other provinces and other countries combined than on Yukon-based establishments. Goods acquired from other provinces were especially important in food, electrical machines, equipment and supplies, while other countries contributed the bulk of metals and metal products. British Columbia provided more goods for all industries combined than the Yukon acquired from its own establishments. British Columbia and Alberta supplied mostly food, machinery and equipment. Of the total shipments made by Yukon wholesalers, nearly all distribution took place within the Territory. Yukon wholesale merchants were engaged in three basic industries - machinery and equipment, food, and petroleum products.

A study completed by DPA on the logistics and costs of transporting foodstuffs into and within the Yukon and NWT indicated that the existing system of cargo transportation into the Yukon consists predominantly of trucking and to a minor extent, air routes. The main southern supply centres are Vancouver and Edmonton. Due to the comparatively well-established road systems into and within the Yukon, and the relatively low costs, trucking is the dominant mode of transportation used for cargo shipment. The air mode is utilized only for urgent or high priority items. The two railway routes, one between Skagway and Whitehorse (the WP&Y) and the other (BCR) from Vancouver to Fort Nelson with trucking from the railhead to Whitehorse, are no longer in operation.

Presently, foodstuffs are transported to the Yukon from Vancouver and Edmonton via two modes - air carriers and trucks. The major air carriers include Canadian Pacific, Pacific Western, and Trans North Turbo air. The former two fly from Vancouver or Edmonton to Whitehorse, while the third carrier offers regional service within the Yukon. There are many

truck carriers into the Yukon. The major ones are Arrow Transportation Systems, Canadian Freightways Ltd., Trimac Transportation System, White Pass & Yukon Corp. Ltd., Yukon Freight Lines Ltd., and Motorway Ltd. Whitehorse, with 60% of the Yukon population, is the distribution centre for the entire Territory. Foodstuff distribution within the Yukon is also primarily by truck. Air carriers are used sparingly.

A recent study completed by Prolog Planning Inc. of Calgary (June 1985) indicated that the Dempster Highway is becoming increasingly competitive with the Mackenzie River barge system in supplying the Beaufort oil and gas activities. The overall strategy recommended by Prolog was to integrate Mackenzie Delta distribution for Beaufort Sea development at Tuktoyuktuk with transportation through the Dempster corridor and a coastal marine connection between Skagway and Vancouver.

Recommended investments included the following:

- . Construction of an all-weather road between Inuvik and Tuktoyuktuk.
- . Installation of ice-strengthened ferries at both Arctic Red River and Peel River crossings to extend the operating season and provide drive-through ferry capability at Arctic Red River to reduce turnaround time.
- . Reconstruction as required, and provision of snow removal and additional maintenance, to facilitate year-round north-bound general freight truck haul on the North Klondike Highway.

These investments were recommended as a means to provide cost savings to Mackenzie Delta with winter as well as summer access to inexpensive water transportation for goods that can be sourced through Vancouver. The study estimated that the combined coastal barge-Dempster truck operations would reduce transportation rates compared to truck from Edmonton. As noted earlier, year-round road access to Skagway is an important component to the plan for reopening the Cyprus-Anvil mine at Faro.

Transportation links with Alaska are viewed as quite limited. The major links are the Alaska Highway to Fairbanks, the road to Haines and then by ship or barge to other tidewater locations, and the road to Skagway and then ship to other points; (until the Skagway road is upgraded, the Skagway route is summer only). There is only one regularly scheduled plane trip to Alaska each week to the city of Juneau. Communication links are also very poor. Yukon mail to Alaska goes from Whitehorse through Vancouver and Seattle to Anchorage. Mail to smaller Alaskan communities can take up to four weeks. Business people therefore have to conduct virtually all of their Alaska business by phone (at considerable additional cost). A number of respondents emphasized that the poor mail service is a serious constraint to expanded trade and business ties between the two

jurisdictions. At each of its past three annual meetings, the Yukon Chamber of Commerce has passed a resolution calling for Canada Post to designate Whitehorse as an international office in order to facilitate mail delivery to and from Alaska.

Opportunities. The potential exists that transportation, wholesale and distribution will be the Yukon economic activities most affected by a Canada-U.S. free-trade agreement. Free-trade will strengthen the arguments for developing the Dempster corridor to supply the Beaufort oil and gas activity as well as the Mackenzie Delta, and could allow some of the proposed developments to proceed before Beaufort oil and gas moves into production. Free-trade, in conjunction with development of the Dempster corridor, would effectively combine three markets - the Mackenzie Delta (population 8,000), the Yukon (population 25,000), and Southeast Alaska (population 65,000). In addition, reduced U.S. trade barriers should increase the capability of southern Canadian producers to supply the Fairbanks market (population 75,000 plus) and other areas of Alaska. This supply could take place either up the Alaska Highway from Edmonton or via coastal barge and the reconstructed year-round road through Skagway. Alaskan producers in the Fairbanks area might also supply southern Canadian markets through shipping down the Alaska Highway.

Closer business ties and greater commercial transactions between Alaska and the Yukon could force the development of improved transportation and communication links between the two jurisdictions. Stated differently, unless air links and the postal system are improved, some of the potential free-trade benefits resulting from closer business ties may not occur.

With these transportation hypotheses, Whitehorse could become a transportation/distribution node -- virtually the center of the wheel -- for the Alaska Highway and coastal barge/Dempster route. For the Yukon to receive the fullest benefit from these transportation changes, the free-trade agreement would need to encompass not only the removal of tariffs, but also simplifications of customs procedures and reductions in the non-tariff barriers which act as impediments to trade in transportation and other services.

Other benefits would include the following:

- . Backhaul from Skagway could reduce the transportation costs of the reopened Cyprus-Anvil mine.
- . More efficient transportation systems, combined with free-trade, could lower the start-up and operating costs of businesses in the Yukon.

Risks. Free-trade and the transportation/distribution systems which could result will mean that many existing transportation and wholesale businesses in the Yukon will

need to establish new relationships with suppliers in the south (both in the United States and Canada) and customers in the north. This will require time, effort, and expense. In addition, the potential exists that transportation companies in Haines and Skagway could penetrate the Yukon market in some fields. The available evidence suggests that free-trade and changes to transportation systems should mean higher volumes and revenues for transportation and wholesale companies in the Yukon, but some existing firms may encounter difficulties in adjusting to the new environment.

Concluding Comment. While the above is consistent with the analysis contained in previous studies, and is supported by the opinions of many respondents, the anticipated benefits to the transportation, wholesale, and distribution sectors in the Yukon are based on a number of assumptions regarding the contents of a free-trade arrangement and how different actors will respond to a new environment. Given both the potential impacts and disruptive effects on existing Yukon businesses, this could be a subject area warranting further research.

Business and Professional Services

Current Status and Potential. The 1985/86 Yukon Business Directory lists by category the businesses located in Yukon which provide business and professional services. The following indicates the number of businesses with offices in Yukon by service category. (Many offices provide more than one service and therefore many are counted more than once).

	<u>No. of Businesses</u>
Accounting and Bookkeeping Services	26
Advertising Services	15
Architects, Engineers, Technical Services	44
Business Services - Other	60
Computer and Related Services	14
Employment Agencies and Personnel Suppliers	2
Lawyers and Notaries	17
Management Consulting Services	23

Most of the businesses appear to be either branch offices of national companies or one-two person operations. The Study Team found no evidence that Yukon based business service firms were active in the Alaskan market or that Alaskan based companies were active in Yukon.

Opportunities. The United States can be expected to make barriers to trade in services an important part of the agenda for the free-trade negotiation. This on balance could be to Yukon's benefit. The evidence collected to date suggests Alaska in the future could become more aggressive in attempting to protect its business service sector from outside (lower 48 states and foreign) competition. Better and more secure access to the Alaskan market could provide opportunities for market expansion to smaller Yukon owned firms and could encourage some national companies to expand their Whitehorse operations in order to better serve the

integrated northern market; (this, however, will occur only if air connections between Alaska, Whitehorse and Yellowknife are substantially improved). The Yukon offers a high quality of life -- studies have shown that other things being equal quality of life can be an important factor in attracting professional and business personnel.

Risks. Free trade will also mean improved access for Alaskan firms to the Yukon market. Because of the scale of the Alaskan boom and the small size of the Yukon market, Alaskan companies have neglected Yukon opportunities. Weakening of the Alaskan economy combined with free trade could alter the situation dramatically, especially if the Canadian dollar strengthens and Alaskan costs decline.

As well, free trade could result in reduced inter-provincial barriers to trade in business and professional services. Therefore, the YTG would be less able to protect Yukon based establishments from competition from the NWT and southern Canadian companies (through local preference procurement policies).

To the extent that free trade lowers barriers to cross-border advertising, the radio station at Juneau may decide to boost its power in order to transmit its signal as far as Whitehorse. This could lead to greater advertising of Alaskan stores and products in the Yukon market, or perhaps to Yukon stores advertising to Canadian customers from the Juneau station. The first outcome could hurt Yukon retailers while the second could hurt Yukon-based advertising companies and radio stations.

Concluding Comment. Free trade in services could provide important market opportunities for Yukon businesses, but the threat of growing competition from Alaskan companies should not be ignored. What might happen is that Alaskan and Yukon companies could specialize in different services, to the benefit of both economies. Greater product and market specialization has been the outcome of free trade areas and customs unions established elsewhere in the world.

Retail Trade

Current Status and Potential. The Yukon's retail trade sector accounts for about 20% of the Yukon's employed work force, and when combined with other services for over 40% of the business establishments of the Territory. The YTG estimates that the value of retail sales in the Yukon was close to \$20 million in 1985. Retail sales typically are closely tied to the performance of the "economic base" or export sectors of an economy (mining, government, etc.). In Yukon, retail sales are influenced in particular by changes in tourism activity. In addition, in an open, frontier economy such as Yukon's, retail trade is closely linked to transportation rates and to retail price differentials between Yukon communities and major cities in the south, especially Edmonton and Vancouver. Many Yukon residents make their big-ticket purchases and purchases of many smaller

items in Edmonton and Vancouver. Consumers therefore could be sensitive to major changes in traditional price differentials between Whitehorse and Vancouver/Edmonton. Over the past four years, the differential between Whitehorse and Edmonton retail prices has ranged between 20.9% (1982) and 24.6% (1984), and the differential between Whitehorse and Vancouver prices has varied between 13.1% (1984) and 16.8% (1983). Consumers can be expected to respond to price differentials which lie significantly outside these ranges.

Opportunities. Because of its strong local market orientation, retail trade could be perceived as the sector which might be least influenced by a free trade arrangement with the United States. However, some potential benefits can be identified.

- . Reduced wholesale prices and transportation rates (from the development of more efficient transportation networks) could allow retailers to expand their profit margins. The extent to which this occurs will depend on barriers to entry and whether higher profits attract new investments into the retail sector.
- . Any reduction in price differentials between Yukon and southern cities (resulting for example from improvements in transportation) could add to retail sales and perhaps retail profit margins in Yukon.
- . The relaxation of non-tariff barriers (related for example to barriers to establishment) could open up franchising opportunities in Alaska for Yukon firms.
- . The retail sector would benefit from the growth in personal incomes, greater business and pleasure travel between Yukon and Alaska, and other economic improvements which could arise from a successful free-trade negotiation.

Risks. Retail businesses could also be negatively affected by some aspects of free-trade. Retailers will need to respond to changes in transportation and distribution networks and will need to establish new commercial relationships. This will cost time and money. If Yukon prices become higher than Alaskan prices (which apparently is not the current situation), Yukon consumers will be able to travel down the highway and shop in Skagway, and tourists on their way to Alaska could reduce their spending in Yukon. (Free trade will likely mean dropping duty-free restrictions for Canadian tourists entering the United States).

Concluding Comment. To the extent that free trade benefits other sectors of the Yukon economy, the retail trade sector can expect to enjoy higher sales, employment and profits. However, some retailers may find it difficult to adjust to a new environment and will face new competition and pressures to keep their prices competitive.

Government

Current States and Potential. As the most important sector in the Yukon economy, government cannot be ignored in any Yukon analysis. Total Yukon and federal government spending in Yukon in fiscal year 1985-86 is estimated to be nearly \$400 M, and total government employment in the third quarter of 1985 was 3,629 or 39% of total full-time employment in Yukon. Over the past three years, rapid increases in capital spending by the YTG have offset limited growth in federal spending (after many years of steady advances). Therefore, government has continued to be a major growth sector in the Yukon economy. The YTG's capital budget is expected to be the major source of growth in government spending for the foreseeable future.

Opportunities and Risks. Government will likely be the sector in Yukon (and Canada) which is least affected by free trade. However, a few potential impacts can be identified.

1. Like other purchasers of goods and services, the Yukon government should benefit from lower prices and the potential to use alternative sources of supply in Alaska and the lower 48 states (rather than southern Canadian suppliers).
2. To the extent that free trade leads to the removal of government procurement preference policies in the ten provinces, free-trade could have a further downward effect on the prices paid by governments for goods and services. It can be argued that these policies have led to the balkanization of some industries (e.g., breweries engineering consulting, management consulting and construction companies) into small inefficient units distributed throughout Canada. On the other hand, dropping preference policies will reduce the ability of the YTG to employ this instrument in the future (see below).
3. Lower consumer prices could reduce pressures to raise government wages during the period when the free-trade agreement is being implemented.

While the net effects of free trade could be positive, the impacts will likely be marginal in relation to total government activities and their dominant role within the Yukon economy.

3.0 ANALYSIS OF ISSUES

Consumer Interest. Yukon consumers should benefit from reduced tariffs, relaxations in non-tariff barriers, possible improvements in transportation systems, and the greater efficiency of the Canadian economy, all of which should be direct or indirect consequences of a free-trade agreement. Canadian producers should become more efficient through the better realization of economies of scale which will result not only from freer and more secure access to the U.S. market

but also from the relaxation of barriers to interprovincial trade within Canada. The question is whether these potential cost savings will be passed on to the Yukon consumer.

The potential exists that some of these cost savings will be retained by retailers or wholesalers in the form of higher profits. To the extent that current profits are marginal, higher profits would not necessarily be a negative development. Higher profit margins would allow establishments to improve their financial positions and perhaps to expand and/or modernize their stores. However, good arguments can be offered to support the view that significant portions of the cost savings will be passed on to the final consumer. The arguments are as follows:

- . there are no obvious or explicit barriers to entry in the Yukon wholesale and retail sectors and therefore higher profits margins should attract new investment;
- . free trade could substantially alter transportation and distribution networks, and disrupt existing commercial relationships; this type of unsettled climate should foster new investments and competition and should help to break down any informal barriers to entry which may exist;
- . consumer prices are expected to fall in southern Canada by a minimum of 5% (the average weighted Canadian tariff after the last Tokyo round cuts have been implemented); at a minimum, Yukon retailers will be under pressure to maintain traditional price differentials with Vancouver and Edmonton;
- . if Yukon prices are too far out of line, Yukon residents will be able to go to Skagway or Haines and purchase many of their consumption requirements (as long as a true free trade relationship is established).

Business Interest. Businesses in Yukon will benefit from lower prices for purchased non-wage inputs, and from better and more secure access to markets in Alaska and the lower 48 states. Some companies will need to adjust to a new economic environment, but the costs of adjustment and the employment losses (if any) should be negligible compared to the more industrialized regions of Canada. The Yukon business community appears to recognize these benefits and limited costs. The business people we talked to supported free trade with the United States, and the Yukon Chamber of Commerce in the recent past was actively considering a free-trade zone between Yukon and South East Alaska.

The major concern uncovered by the Study Team is the limited knowledge of business people regarding the Alaskan market, and potential competitors from that state. The Alaskan boom has come to an end. This can be expected to mean falling prices and costs, and greater policy emphasis on economic diversification and small business development. It cannot be blindly assumed that economic conditions which prevailed in

Alaska over the past 10-15 years will continue for the next decade, the period when a free-trade agreement could be implemented. Yukon business people need to know more about the current and future economic conditions in the state and potential Alaskan competitors in various product and service markets.

Labour Interest. The Yukon Federation of Labour can be expected to closely follow the position of the Canadian Labour Congress and other labour groups in Canada. Labour's position is that Canada should not enter into a free-trade negotiation with the United States, and that these agreements with the U.S. should be restricted to sectoral agreements such as the Canada-U.S. autopact. (In the Study Team's view, there are no obvious Yukon industries which could participate in and benefit from a sectoral trade agreement). The YTG may or may not agree with labour's position of total opposition to a free-trade negotiation and agreement with the United States. However, some of the concerns expressed by the CLC and the national NDP should be fully addressed by the YTG and other Canadian governments. These concerns relate to:

- . northern benefits packages and northern tax exemptions
- . Canadian social welfare programs
- . effects on economic, political and cultural sovereignty
- . implications for small business, native, northern development and farm programs
- . effects on Canadian employment
- . effects on trading relationships with third countries
- . need for a U.S./Canada Trade Commission to provide information and assist in settling disputes

Some of these concerns are further discussed below from a Yukon perspective and labour concerns about Canada-U.S. free trade are further summarized in Appendix B.

Potential Net Benefits to Yukon Economy of Canada - U.S. Free Trade . The Canada West Foundation attempted to estimate the consumers costs of the Canadian tariff. The Foundation noted the difficulties of measuring the true costs and benefits of Canada's protectionist policies. Much depends on consumption patterns, the degree to which domestic producers price up to international prices plus the tariff, as well as the sensitivity of both industry employment and consumer buying behaviour to product prices. In addition, the significant impacts of non-tariff barriers are virtually impossible to measure.

Taking import duties collected in Canada as a simple proxy for the cost of our tariffs, the Canada West Foundation estimated each Canadian resident paid an additional \$113.75 in 1983 as a result of Canadian tariffs. When applied to Yukon's population of 25,000, the total cost of Canadian tariffs to Yukon residents is estimated to be about \$2.8 million. Because of import tariffs, Canadian industry is able to earn more revenue and sell more products than would otherwise be the case. Total import duties collected again can be used as a rough proxy for the tariff benefit given Canadian

industry by national trade policy. This can be viewed as an indirect subsidy to manufacturing employment. Dividing total import duties by Canadian manufacturing employment results in an average subsidy of \$1590 per industrial worker in 1983. With Yukon manufacturing employment of about 100, the aggregate benefit to Yukon from Canadian tariffs is estimated at about \$160,000. Therefore, the net loss to Yukon of Canada's tariff system amounts to more than \$2.6 million or about \$107 to each Yukon resident.

The Canada West Foundation research addresses all Canadian tariffs. Canada-U.S. free trade will reduce most but not all Canadian tariffs (since tariffs on third country imports will remain). On the other hand, the Foundation's research did not address the significant impacts of NTB's or the fundamental effects of protection on Canadian productivity and competitiveness. Previous research reviewed by the MacDonald Commission led the Commissioners to conclude that Canada-U.S. free trade could raise Canadian GNP by 3 to 8 percent. Economic gains of this magnitude if those gains accrue to the Territory would add between \$500 and \$1200 to the average per capita income of Yukon residents. Adding in the benefits from lower prices, the improvements to Yukon per capita income would be between \$600 and \$1300.

Economic, Political and Cultural Sovereignty. The possible effects of free trade on Canadian economic, political and cultural sovereignty are highly emotional issues and each Canadian will need to develop his/her own views. Yukoners in general may take a more objective and pragmatic view of these issues than residents of some other parts of Canada. There could be three reasons for this.

1. Yukon has not yet achieved full provincial status.
2. Yukon is the most open economy in Canada and perhaps all of North America and already sells most of its products in a "free trade environment."
3. Yukon has few "cultural establishments" and therefore receives few direct benefits from federal programs targetted towards protecting Canadian cultural sovereignty and developing cultural industries.

As Canadian citizens, Yukon residents will be interested and concerned in these issues, but the concerns are perhaps more detached and less emotional than in other parts of the country.

The personal view of the DPA Study Teams is that the link between trade arrangements and economic, political and cultural sovereignty can be overstated. The countries of the European Common market and of the Australia-New Zealand free trade area have continued to have their own political and cultural identities after the original agreements were signed. The free-trade arrangements do influence economic policy making, but do not prevent member countries from following independent monetary, fiscal and development policies. The influence of free trade is related more to the

selection of the levers to be employed. Often, policy makers have available to them an array of instruments to achieve a given economic objective. Free trade means the policy maker must select an instrument which is least disruptive to trade with the member country or countries of the free trade arrangement.

Opponents of free trade have argued that the United States will dominate Canada in any free-trade arrangement. There is little evidence, however, that the United States is interested in political domination of Canada (while some would argue that cultural domination is already a fact). The counter argument is that free trade, by strengthening the Canadian economy, will expand Canadian political self-confidence and the ability of the Canadian Government to implement independent economic and cultural policies and programs.

In the final analysis however, each Canadian will need to decide for themselves whether free trade will have a favorable or unfavorable effect on Canadian political and cultural sovereignty.

Economic Development Programs. The current Yukon government is concerned that a free-trade arrangement could constrain its ability to influence the future direction of the Yukon economy. The new government was elected with a mandate to improve the performance of the Yukon economy. Economic diversification, greater emphasis on renewable resources, import substitution, small business development, native development, and community development are all important aspects of the five-year agenda of the YTG. Rhetoric from both Ottawa and Washington suggest that Canada's industrial and regional development programs are important irritants in Canada-U.S. trade relations and will play a major role in the free trade discussions. The danger exists that the present federal government, in the name of free trade but in reality as part of austerity, will back away from many of the economic development programs important to Yukon.

The Study Team questions however whether a free trade settlement will directly affect the northern, native and small business programs operating in the Yukon. There are three reasons for this:

1. Research presently being conducted by the federal government can be expected to show that U.S. governments are nearly as active in these program areas as Canadian governments. The major problem is that in the U.S., most economic development programs are implemented at the state and municipal levels. These programs may be less obvious but are apparently just as effective as federal development programs in Canada (otherwise how can we explain a Japanese automobile plant in Tennessee). Devolution of development programs in Canada from the federal level to provincial, territorial and other jurisdictions could provide the appearance of

"equivalency" and help to neutralize this issue at the bargaining table.

2. American concerns should be directed (at least theoretically) at export subsidies. The purpose of countervailing duties is to levy duties on an import to offset subsidies received by the foreign exporter from its own government. Development programs in Yukon are not directed toward subsidizing exports, but rather toward offsetting the higher cost of doing business in the north and the limited access of natives and other northerners to equity and other forms of financing. For those assisted businesses which ultimately export their products, the effects of Yukon programs on export capabilities should be minimal and therefore the products should not be subject to U.S. countervailing duties (and to U.S. concerns in a free-trade negotiation). Based on these arguments, we would expect American negotiations to focus more on IRDP grants to manufacturers in Canada's industrial heartland near the American border, than on northern and native economic development programs.
3. Programs operating in the north have small budgets and relatively modest objectives, and therefore might be ignored by U.S. negotiators.

Nonetheless the danger exists that northern programming could be seriously curtailed as a side-effect of a successful negotiation. The potential also exists that free trade could facilitate a rationalization of Canadian economic development programs in a manner which would benefit the less developed areas of Canada. The trend since the mid-1960's has been to extend the coverage of regional development programs to more and more regions in Canada, to the point where all parts of Canada are now eligible for industrial grants under IRDP. The Study Team's view is that this trend has hurt the relative effectiveness of federal development programs in the less developed parts of Canada, including Yukon. Free trade, (combined perhaps with austerity and decentralization) could be used as a lever to remove programming from the more industrialized Canadian regions (where subsidies are more closely linked to exports) and target the remaining program funds on the less developed regions. This potential could become a reality through strong negotiating from the less developed regions (as part of their acceptance of a free-trade agreement). Yukon may wish to explore the development of a common negotiating position with the NWT, the four Atlantic provinces and perhaps some of the western provinces.

Regardless of the above, the YTG should be wary of federal program cutbacks which are made in the name of free trade but in reality are simply federal austerity measures. The YTG position on free trade should be very clear on this point.

Social Programs. Despite the rhetoric coming from both Washington and Ottawa, it is difficult to believe that a free trade arrangement will seriously compromise Canada's social programs. For every argument from Washington that UIC or some other social program subsidizes Canadian export industries, Canadian governments and businesses can offer counter-arguments that the high taxes needed to pay for those programs hurt the international competitiveness of Canadian industry. Our view is that supporters of Canada's social programs have more to fear from federal austerity measures than from a free trade agreement. Regardless, similar to the concluding comment under economic development programs, the YTG should adopt the position that the free trade negotiation should not be used as an excuse to dismantle Canada's social programs. Federal Canadian politicians, officials and negotiators -- and politicians and negotiators in Washington -- hopefully recognize that the cause of free trade is not helped by using free trade as a hammer to pursue other policy objectives. Reduction of the federal deficit, economic development programs to assist less advantaged regions and groups, and Canada's social programs are separate issues which should be discussed in their appropriate forums.

Native Economic Development. Like other Yukon businesses, native owned businesses and development groups should benefit from lower prices of purchased inputs as well as freer and more secure access to the Alaska market. Yukon's native residents are currently considering business opportunities in a number of sectors including: tourism, sawmills, construction, trucking, trapping, and arts and crafts. Opportunities could include new enterprises which are fully native owned, joint ventures with non-natives, or purchasing existing non-native businesses. Native businesses could possess the potential to benefit even more from free trade than non-Native businesses in Yukon. Alaska's large Native development corporations could offer natural markets for the products of Yukon Native businesses. Closer business ties could mean opportunities for joint ventures between Native businesses and development corporations in both jurisdictions. These joint ventures could be facilitated by the Jay Treaty which allows Natives in Alaska and Yukon to work on both sides of the border, as well as family ties with Alaskan natives. Closer relations could also allow Yukon native-business groups to learn from the successes and mistakes of the Alaska native development corporations.

On the other hand, native groups in Yukon could be concerned that free-trade could compromise native economic development programming in the Territory, and likely will be particularly interested in the YTG's position on this issue.

Inter-Provincial Barriers to Trade. These are discussed below under three headings:

1. Government procurement
2. Agricultural marketing boards
3. Liquor control boards

The Study Team's view is that, because of the small size of the Yukon economy, Yukon receives limited benefits from the application of these policies in the Territories, but that Yukon residents are significantly hurt by their application in the ten Canadian provinces. All three measures significantly increase prices to Canadian governments, taxpayers and consumers.

The YTG does have a local procurement preference policy but we understand the policy is not applied very often and that the benefits from its application are being debated. Purchasing lumber from a local retail outlet ensures the retail markup (perhaps 10-20% of the purchase value), is retained in Yukon, but does not help to support lumber production in the Territory. The YTG is currently looking at other initiatives to support local industry. These could include:

- ensuring maximum use of local products in the design of buildings (even if the construction cost is higher)
- making it easier and cheaper for local industry to bid on contracts
- providing direct support to pilot projects and local industry to assist them in (for example) producing wood furniture for government offices
- splitting up purchases into smaller contracts to better enable small local firms to compete for the work.

Our view is that these alternative initiatives, properly applied, can be more effective than across-the-board local preference policies, and are less likely to be constrained by a free-trade settlement.

Yukon residents receive no benefits from the last two barriers but experience the higher prices which they cause. Based on the NWT experience, agricultural marketing boards could hurt Yukon agricultural development to the extent that some Yukon producers could be prevented from selling in northern BC and Alberta markets.

Based on these considerations, the YTG should be less concerned about the removal of these barriers than the ten provincial governments, and in fact may wish to support their reduction as part of a free-trade agreement. This position, however, should be based on fairly detailed analysis and identification of alternative measures which the YTG can employ to achieve its economic development objectives.

Investment Policy. In contrast to common markets, free trade areas do not require the free movement of labour and capital among the member countries. Nonetheless, the US government can be expected to express serious concerns regarding past Canadian policies on foreign investment. Compared to other parts of Canada, Yukoners and the YTG generally have expressed fewer concerns regarding foreign investment and control in the Territory. The possibility that free trade will bring in more American investment into the Yukon could be viewed as a mixed blessing by some Yukon residents, but others will view the foreign investment as capital essential

to Yukon's development. In light of the need for foreign capital in Yukon, the YTG position on this issue may need to be cautious. The YTG stance may be to monitor the negotiations to ensure the federal position will not act as a constraint to Yukon acquiring the foreign capital needed for its long-term development.

Although Yukoners generally endorse relatively open foreign investment policies, foreign investment is excluded from two Yukon industries. Outfitting operations must be owned 51% or more by Yukon residents who have lived in the Territory for at least a year, and minority owners must be Canadian citizens. Trapping is limited to Yukon residents who have lived in Yukon for at least three years and who are Canadian citizens. These investment restrictions are not intended as trade barriers, but reflect concerns to manage vulnerable and limited resources to the benefit of Yukon residents, especially those of native ancestry. The free-trade agreement should not affect the YTG's ability to exclude foreign investment from particularly vulnerable activities.

Trade with Third Countries. Yukon could be negatively affected by a Canada-US free trade arrangement which is perceived as a threat to third countries, especially Canada's trading partners in the Pacific Rim. It is essential, therefore, that the agreement be designed to build on and supplement the GATT and not be perceived as a replacement for the GATT. Moreover, the agreement should be fully consistent with the letter and spirit of Article XXIV of the GATT in that it results in no new barriers to trade with third countries and encourages third countries to join a section or all of the free trade arrangement. If the negotiation moves in a direction that could be perceived as injurious to the trading interests of third countries important to Yukon, the YTG should reserve the right to qualify or remove its support to the free-trade negotiation.

Transition Arrangements. As noted above, few Yukon businesses should be negatively affected by free trade, and the employment losses in Yukon (if any) should be minimal. Nonetheless, the YTG should support an extended transition or phase-in period for implementing the tariff cuts and the reductions in non-tariff barriers in Canada. A transition period of a minimum of five years will allow the YTG to implement its own economic development agenda in the areas of import substitution, small business development, community development, and native economic development.

Import Substitution. A free-trade arrangement implemented over an extended period will allow businesses to pursue import substitution opportunities with the full knowledge that a larger market (Alaska) will become available to them once their business is fully established and operating successfully. An appropriate transition period means that import substitution and support to free trade are complementary, not conflicting policies. This holds the implication, however, that import substitution and small business initiatives should focus on establishments and

products that hold strong potential for being profitable over the medium to longer term. Potentially viable opportunities should be supported for two reasons:

- Under free trade, Yukon producers will be facing heightened competition in their own markets by the early 1990s.
- The already hard pressed Yukon consumer cannot afford to pay even higher prices for goods and services (in the name of import substitution and self-sufficiency).

This perspective is consistent with the approach being taken by DPA in a companion study on the assessment of import substitution opportunities in Yukon.

The situation described here is not inconsistent with the YTG providing operating subsidies to selected operations that are seen as important pilot projects or are critical to other activities and sectors. Free trade will mean, however, that the operation to be subsidized and the form of the subsidy should be carefully selected so that the assistance cannot be perceived as an export subsidy by the United States. (If it is so perceived, the US government can place a countervailing duty on the imported good which could totally offset the value of the grant.)

Dispute Management. It is essential that some type of dispute settlement vehicle be established under the free trade arrangement. The instrument should be effective not only in settling disputes between the two national governments, but also between state and provincial/territorial governments. The vehicle, no matter how it is structured, should have sufficient scope and weight to quickly resolve the kind of dispute with the Alaska government which recently delayed the opening of the Cyprus-Anvil mine. The vehicle should operate to de-politicize issues and to allow problems to be reviewed and resolved in an unemotional atmosphere on their own merits.

Customs Procedures. A number of people interviewed for this study reported that complicated customs procedures on both sides of the border, not tariffs, are the largest impediments to expanded two-way trade between Yukon and Alaska. The time, effort, and cost of satisfying these procedures can act as an absolute constraint to exporting by small producers and to test marketing by small and large firms. The brokerage fee is a minimum of \$150 (U.S.) regardless of the value of a shipment. The documentation for a large shipment can require many hours or even days to complete. Furthermore, customs brokers are located in Anchorage, hundreds of miles from Yukon's natural markets in Southeast Alaska. Yukon businesses could benefit enormously from simplified and streamlined customs procedures and documentation. Small manufacturers could also benefit from greater standardization of labelling and packaging requirements.

Coverage. Our analysis suggests the Yukon would benefit from an agreement that is broad in scope and very explicit about exclusions. This implies the following:

1. Both tariff and non-tariff barriers should be significantly reduced.
2. Security of access to the US market (especially for goods now entering duty-free) should be guaranteed to the greatest extent possible.
3. The agreement should cover trade in both goods and services.
4. The agreement should be open to any other country that might wish to participate in all or even a single component (e.g., a protocol on services). The agreement could be made available to other countries on a conditional, most-favoured nation (MFN) basis so that any country willing to accept the rules of the free trade agreement could become a member. The invitation to participate in all or part of the agreement should be made explicitly to Japan, South Korea, and other Pacific Rim countries important to Yukon exports.
5. Exclusions should be limited and as explicit as possible. Vague references open to several interpretations could be a problem for Yukon (and perhaps Canada as a whole). In any dispute with Alaska over the interpretation of a clause, Yukon (and Canada) may lack the political clout to carry the day. Less powerful partners generally are best protected by explicit language.

Recent news releases suggest the Canadian government has already removed two issues from the free trade agenda, agricultural marketing boards and cultural industries. As Canadians, Yukon residents should be concerned about the effects of free trade on agriculture, cultural activities, and any other vulnerable industries. At the same time, Yukoners do not benefit significantly from either set of policies, and need to be concerned about the US response to the Canadian exclusions. The items the United States removes from the agenda could be of great significance to Yukon's future economic prospects. The negotiation will be played like a game of poker -- showing your cards early is not the best strategy.

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ANNEX TO APPENDIX A:

BACKGROUND STATISTICS ON THE YUKON ECONOMY

TABLE 1: BASIC INDICATORS ON THE YUKON ECONOMY

Yukon Population: 1951-1985

Year	No.
1951	9,096
1961	14,628
1971	18,390
1981	23,153
1985 (estimate)*	25,138

* Health Care Population Estimate. Earlier figures are from the Population Census of Statistics Canada. Assuming that the 1981 ratio between the Health Care estimate and the Census prevailed in 1985, the 1985 estimate would be 22,700.

Yukon Unemployment Rate (Annual Average): 1979-1983

Year	%
1979	14.6
1980	12.9
1981	11.2
1982	13.3
1983	14.1

Full-Time Employment by Sector: 1981-85 (Third Quarter)

Sector	1981	1983	1985
Total	11,684	9,164	9,346
Mining	1,753	556	550
Forestry	26	26	68
Construction	663	841	482
Service	3,716	3,046	3,741
Transport	980	466	345
Communications and Utilities	501	399	531
Government	3,845	3,830	3,629
Other	200	--	--

TABLE 1 continued

Total Value of Mineral Production: 1979-84

Year	\$M
1979	299.2
1980	359.9
1981	235.6
1982	168.6
1983	58.8
1984	56.6

Yukon Border Crossings: 1979-84

Year	No.
1979	362,174
1980	340,440
1981	386,772
1982	365,057
1983	394,154
1984	422,094

Source: Yukon Statistical Review: Various Issues.

TABLE 2: YUKON AND CANADA; DISTRIBUTION OF EMPLOYED LABOUR FORCE: 1981

	Yukon		Canada	
	No.	%	('000)	%
All Industries	12,590	100.0	11,168	100.0
Agriculture	85	0.7	470	4.2
Forestry	80	0.6	84	0.8
Fishing and Trapping	40	0.3	33	0.3
Mining	1,440	11.4	203	1.8
Manufacturing	335	2.7	2,135	19.2
- Food and Beverage	20	0.2	284	2.5
- Wood Industries	90	0.7	142	1.3
Construction	945	7.5	694	6.2
Transportation Construction and Other Utilities	1,645	13.1	918	8.2
- Transportation & Storage	1,140	9.1	543	4.9
- Communication	400	3.2	245	2.2
Trade	1,760	14.0	1,892	16.9
- Wholesale Trade	480	3.8	543	4.9
- Retail Trade	1,280	10.2	1,348	12.1
Finance, Insurance & Real Estate	525	4.2	614	5.5
Community Business & Personal Services	3,170	25.2	3,263	29.2
- Education & Related Services	630	5.0	755	6.8
- Health and Welfare Services	490	3.9	840	7.5
- Business Services	440	3.5	464	4.2
- Personal Services	85	0.7	175	1.6
- Accommodation & Food Services	1,090	8.7	605	5.4
Public Administration & Defense	2,570	20.4	863	7.7
- Federal	1,105	8.8	369	3.3
- Provincial	935	7.4	253	2.3
- Local	530	4.2	227	2.0
Males				
Average Employment Income: 1980\$	19,409		16,988	
Median Employment Income: 1980\$	19,747		15,804	
Females				
Average Employment Income: 1980\$	10,742		8,863	
Median Employment Income: 1980\$	9,681		7,847	

Source 1981 Population Census of Statistics Canada.

TABLE 3: YUKON MANUFACTURING SECTOR: 1982

No. of Establishments	9
Value of Shipments (\$'000)	8,046
Cost of Materials & Supplies (\$'000)	3,571
Cost of Fuel (\$'000)	412
Manufacturing Value Added (\$'000)	2,711
Total Employment	92
Salaries & Wages (\$'000)	1,913

Source: Statistics Canada 31-203, Manufacturing Industries of Canada: National and Provincial Areas, 1982. This document does not distribute Yukon manufacturing by industrial sector. As well, the Statistics Canada document Destination of Shipments of Manufacturers (31-530) does not separate Yukon from NWT shipments.

TABLE 4: DOMESTIC EXPORT BY PROVINCE OF LADING BY CLASS AND COUNTRY: YUKON, JANUARY-DECEMBER 1984

Class	Country	\$'000*
Cattle	USA	50
Animal Material Used in Manufacturing	USA	98
Crude Animal & Fish Products	USA	258
Lead Ores & Concentrates	Belgium-Lux.	8,146
	Germany West	2,308
	Netherlands	<u>1,325</u>
	Total	11,777
Silver Ores & Concentrates	Belgium-Lux.	1,475
	Netherlands	<u>20</u>
	Total	1,495
Zinc Ores & Concentrates	Belgium-Lux.	59,353
	Germany West	6,876
	Netherlands	<u>11,073</u>
	Total	77,302
Lumber: Spruce, Pine, Fir	USA	544
Inorganic Acids & Oxygen Compounds	USA	841
Propane Gas, Liquefied	Total	86
Silver	Total	96
Petroleum, Coal, Gas Products	Netherlands	144
Construction Machinery & Equipment	USA	122
Aircraft Complete	USA	62
Outerwear Knitted	USA	162
Antiques & Collectors Items	USA	162
	Other	<u>55</u>
	Total	217
Contractors Equipment & Tools	USA	2,720
Total Exports	All Countries	96,580
Total Imports**	All Countries	6,146

Notes to Table 4:

- * All items greater than \$50,000.
 - ** A brief review of the items imported suggests that very few imports were produced in Alaska. Major import items (purchases of greater than \$100,000) include wines and liqueurs, motor vehicles, aircraft parts, telephone parts, mining equipment, and used tractors.
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TABLE 5: NUMBER OF BUSINESSES AND EMPLOYEES BY SIC CATEGORY, YUKON

	Businesses		Employees	
	No.	%	No.	%
Total	1,506	100.0	5,908	100.0
Agriculture	20	1.3	32	0.5
Logging	10	0.7	17	0.3
Mining	23	1.5	639	10.8
Manufacturing	61	4.1	209	3.5
Construction	166	11.0	476	8.1
Transportation	117	7.8	694	11.7
Communication	19	1.3	424	7.2
Wholesale Trade	43	2.9	211	3.6
Retail Trade	288	19.1	1,286	21.8
Finance	17	1.1	139	2.4
Real Estate	25	1.7	87	1.5
Business	128	8.5	318	5.4
Educational	24	1.6	24	0.4
Health and Social	42	2.8	112	1.9
Accommodation	163	10.8	881	14.9
Other Services	360	23.9	359	6.1

Note: 'Employees' includes both full and part-time.

Source: The Yukon Business Community. A Statistical Overview for 1985. YTG Bureau of Statistics.

TABLE 6: NUMBER OF SERVICES BY SIC CATEGORY AND BUSINESS CLASSIFICATION

SIC Category	Services No.	Services %	Order of Business Classification					
			1st	2nd	3rd	4th	5th	6th
Yukon	3,023	100.0	1,506	775	409	210	91	32
Agriculture	46	1.5	20	15	5	5	1	0
Logging	24	0.8	10	8	3	2	1	0
Mining	35	1.2	23	10	1	1	0	0
Manufacturing	148	4.9	61	43	24	13	6	1
Construction	450	14.9	166	133	86	45	17	3
Transportation	223	7.4	117	58	27	14	5	2
Communication	28	0.9	19	8	1	0	0	0
Wholesale Trade	109	3.6	43	32	16	8	7	3
Retail Trade	618	20.4	288	171	90	46	19	4
Finance	34	1.1	17	9	7	1	0	0
Real Estate	45	1.5	25	10	6	3	1	0
Business	246	8.1	128	74	30	13	1	0
Educational	45	1.5	24	12	7	2	0	0
Health & Social	52	1.7	42	8	2	0	0	0
Accommodation	423	14.0	163	94	69	49	29	19
Other Services	497	16.4	360	90	35	8	4	0

Source: The Yukon Business Community. A Statistical Overview for 1985. YTG Bureau of Statistics.

TABLE 7: POST-TOKYO ROUND TARIFFS ON INDUSTRIAL PRODUCTS BY
SECTOR: CANADA, UNITED STATES, AND ALL INDUSTRIAL
COUNTRIES (PERCENTAGE)*

Sector	Canada	USA	All Industrial Countries
Textiles	16.7	9.2	8.5
Wearing Apparel	24.2	22.7	17.5
Leather Products	6.3	4.2	3.0
Footwear	21.9	8.8	12.1
Wood Products	3.2	1.7	1.9
Furniture & Fixtures	14.3	4.1**	7.3
Paper & Paper Products	6.7	0.2	4.2
Printing & Publishing	1.0	0.7	1.5
Chemicals	7.5	2.4	6.7
Rubber Products	6.7	2.5	4.1
Nonmetal Mineral Products	6.4	5.3	4.0
Glass and Glass Products	7.2	6.2	7.9
Iron and Steel	5.4	3.6	4.4
Nonferrous Metals	2.0	0.7	1.6
Metal Products	8.5	4.8	6.3
Nonelectrical Machinery	4.5	3.3	4.7
Electrical Machinery	5.8	4.4	7.1
Transportation Equipment	1.6	2.5	6.0
Miscellaneous Manufacturers	5.4	4.2	4.7
All Industries	5.2	4.3	5.8

NB. Although American tariffs are generally low, tariffs on items of potential interest to small scale Yukon manufacturers can be high. For example, tariffs on jewellery can range from 5 to 25%, and tariffs on outerwear can be as high as 40%, depending on the classification applied by US customs officials.

* Weighted by own-country imports, excluding petroleum.

** Estimated from incomplete data.

Source: A.V. Deardorff and R.M. Stern, "Economic Effects of Complete Elimination of Post-Tokyo Round Tariffs", in W.R. Cline, Ed., Trade Policy in the 1980s (Washington, DC: Institute for International Economics, 1983), pp. 674-675.

TABLE 8: CANADIAN TARIFFS: SUMMARY BY GROUP

Group	Tariff*
1. Animals, Agricultural Products, Fish and Provisions	Many items are free; other items (e.g., processed food products) have tariffs up to 20%.
2. Sugar, Molasses, and Manufactures Thereof	Great variation depending on the item. Can be up to 20%.
3&4. Tobacco and Liquor.	Generally quite high.
5. Pulp, Paper, & Books	Many items are free; others up to 15%.
6. Drugs, Waxes, Soaps, & Oils	Typically in the 5-15% range.
7. Earths, Earthenware, & Stoneware	Generally in the 5-18% range.
8. Metals & Manufactures Thereof	Many items are free, but tariffs increase with degree of processing (generally 5-20%).
9. Wood & Manufactures Thereof	Unprocessed generally free. Processed generally from 5-15%.
10. Textiles & Manufactures Thereof	Tariffs generally from 5-25%. Many items in the high part of the range.
11. Miscellaneous Manufactured Goods	Generally 5-25% with many in high part of range.
12. Chemicals, Plastics, etc.	Some free; others in range of 5-25%.

* MFN (Most Favoured Nation) basis.

Source: McGoldrick's Canadian Customs and Excise Tariffs.

APPENDIX B

**SUMMARY OF BENEFITS AND COSTS
OF CANADA/US FREE TRADE TO CANADA
AS CITED IN THE LITERATURE**

APPENDIX B

SUMMARY OF BENEFITS AND COSTS TO CANADA
OF CANADA/US FREE TRADE
AS CITED IN THE LITERATURE

1.0 INTRODUCTION AND SUMMARY

This working paper summarizes the benefits and costs to Canada of Canada/US free trade noted in the recent literature. Two studies were especially useful in presenting the issues and providing references to other studies. The summaries are drawn from either the references cited or from one of the following excellent introductory studies:

- . Hill, Roderick and John Whalley, "Canada-US Free Trade: An Introduction," in John Whalley, Canada-United States Free Trade, Vol. 11 (eleven) of the collected research studies for the Royal Commission on the Economic Union and Development Prospects for Canada.
- . Lipsey, Richard G. and Murray G. Smith, Taking the Initiative: Canada's Trade Options in a Turbulent World.

The Royal Commission on the Economic Union and Development Prospects for Canada (the Macdonald Commission report of 1985) provides a good summary of the benefits and costs from the perspective of an advocate of Canada-US free trade. The Commission's support for free trade is based on one overriding consideration. Although Canada is the United States' largest trading partner, Canada accounts for less than 20% of US external trade (imports plus exports) while the United States accounts for over 70% of Canada's external trade. This imbalance causes concern because trade with Canada is quantitatively less important to Americans than to us. It would be possible for the American government to implement protective trade measures harmful to Canadian interests and be relatively unaware of, or unconcerned by, their consequences for Canada. The Commission concluded it is imperative for Canada to reduce both the uncertainty of its access to US markets and the adverse effects that might result from any trade restrictive measures.

The Macdonald Commission notes the following major advantages from Canada-US free trade:

1. Free trade would reduce exposure of Canadian exporters to American non-tariff barriers (NTBs) and therefore increase our security of access to the American market.
2. Free trade would improve our access to the US market in areas where that country now employs tariff and NTB protection.

3. Improved and more stable access would create opportunities for Canadian business to accelerate the trend toward specialization and rationalization of Canadian production, thereby enhancing the productivity and competitiveness of Canadian industry. By becoming more competitive with American firms, Canadian firms would also increase their ability to survive in a more competitive, global trade environment.

The Commissioners were impressed with the view that in many respects Canadian producers face the worst of both worlds, protection and free trade. Because of the tariff cuts from the Kennedy and Tokyo rounds, Canadian tariffs are generally too low to provide protection to most Canadian manufacturers. At the same time, the remaining US tariffs, combined with the threat of non-tariff barriers, prevent secure access to the large American market, thereby deterring investment beyond that necessary to service the Canadian market. The consequence is growing competition at home without guaranteed access to a large export market.

The Commissioners concluded that after the Tokyo Round tariff cuts are fully implemented, the long term gains to Canada from Canada-US free trade lie in the range of 3-8% of Canadian GNP. The Commissioners go on to say that all regions will benefit and Canadians in all parts of the country will enjoy a higher standard of living as a consequence of Canada-US free trade. The Macdonald Commission recognizes the potential economic costs -- including some withdrawal of investment, employment adjustments, and other disruptions -- but concurs with previous studies that economic benefits will be many times greater than the economic costs.

A final issue is whether the economic benefits and costs identified for Canada as a whole are relevant to Yukon. One hypothesis is that Yukon's relationship to Alaska is a microcosm of Canada's relationship to the United States. The US economy is at least ten times greater in size than the Canadian economy; the Alaskan economy is 25 times larger than the Yukon economy. To the extent that Canadians in general will benefit from closer ties and improved access to a larger national market, we would expect Yukoners to benefit from closer ties to a much larger state economy. Yukon manufacturers of specialty items, Yukon producers of lumber, agricultural and fish products, and Yukon business service firms will ultimately require improved and guaranteed access to a larger market to support future expansion. Without that access, Yukon companies will be severely constrained by the small size of the Territorial market. Arguments can therefore be made that the economic benefits identified for Canada as a whole may have some relevance to the Yukon situation.

There are some important differences between the Yukon and Canadian situations. On the negative side, because the Yukon economy is underdeveloped, the benefits will be less

immediate. Many of the economic opportunities from free trade will not occur for many years and will require supporting actions from government (e.g., improved communications and transportation systems with Alaska).

Three differences can be viewed as positive from the Yukon perspective:

1. Because the Territorial economy is undeveloped, the potential economic costs are not obvious. Our respondents were unable to identify a single Yukon job that would be directly threatened by Canada-US free trade. The most significant potential threat might be the constraints free trade could place on future Territorial and federal government initiatives to guide the Yukon economy.
2. Because the Alaskan economy is also undeveloped, the competition from Alaskan businesses will not be immediate.
3. Potential competition from Alaskan businesses is further dampened by the state's very high wages and non-labour costs compared to Yukon.

This analysis suggest that over the longer term Yukon may have more to gain -- and less to lose -- from free trade than some other parts of Canada. However, because most benefits lie well into the future, Yukon benefits and opportunities are also less certain in part because of their critical dependence on future relationships between Alaskan and Yukon costs and the value of the Canadian dollar.

It should be emphasized that there are strong opponents to Canada-US free trade, the most articulate ones being the representatives of the labour movement. Their major concerns are as follows:

- . substantial job losses in the more industrialized regions of Canada
- . potential erosion of Canadian economic, political and cultural sovereignty
- . growing dependence on the American market and government, and on U.S. producers for the product needed by Canadian industry and consumers
- . potential changes to Canadian social welfare programs, our labour legislation and practices, and Canada's tax and regulatory environment, in order to allow Canadian producers to be competitive with American manufacturers
- . the virtual removal of our ability to use non-tariff barriers to achieve economic and social objectives
- . loss of the safeguards and other favorable features of the Canada-U.S. Autopact.

Labour's concerns are summarized in three documents reviewed at the end of Section 2.0 below.

2.0 REVIEWS OF PREVIOUS RESEARCH

- | | |
|------------------------|---|
| REFERENCE | Young, John H., <u>Canadian Commercial Policy</u> , prepared for the Royal Commission on Canada's Economic Prospects, Queen's Printer, Ottawa, 1957. |
| STUDY OBJECTIVES | <ul style="list-style-type: none"> . One of the earliest attempts to quantify the cost of Canadian tariffs. . Sought to estimate the cash cost to Canadians of tariffs. . Used 1954 data on output, covering expenditures in 13 categories of goods. . Compared Canadian prices (net of taxes) with foreign (generally US) goods (net of tariffs but including transport costs). . Measured added revenue due to higher prices and misallocation of resources in additional production resulting from tariff protection in Canada. |
| BENEFITS OF FREE TRADE | <ul style="list-style-type: none"> . Estimated the cost of tariffs at between \$0.6 and \$0.75 Billion (1954 Canadian dollars). . This is the equivalent of 3.5-4.5% of gross private expenditure (net of indirect taxes such as excise and sales tax). . Considered that other factors such as the higher cost of goods purchased by government because of tariffs would increase the cash costs of tariffs to \$1 Billion. |
| CONCLUSION | "In general and over the long run, increases in protection can be expected to lead to economic losses and decreases in protection to economic gains for the country as a whole." |

REFERENCE

Wonnacott, Ronald and Paul Wonnacott, Free Trade Between the United States and Canada: The Potential Economic Effects, Harvard University Press, Cambridge, Mass., 1967.

STUDY
OBJECTIVES

- . First major study of possible effects of bilateral Canada-US free trade.
- . Examined industry location on a free trade continent.

BENEFITS OF
FREE TRADE

- . Concluded Canadian industry would face only minor non wage cost disadvantages under bilateral free trade.
- . Removal of barriers would increase Canadian industries' efficiency through economies of scale, lowering consumer costs and increasing exports.
- . Using 1958 data on wages, adjusted for the different structure of employment between the two countries, they found Canadian wages were about 30% lower than US wages in manufacturing.
- . They assume upward pressure on wages would close this gap in the long run after free trade.
- . They also assume the exchange rate would rise to parity (8% rise given their data).
- . The cost to Canada of US and Canadian tariffs in the form of lower Canadian wages (in the absence of free trade) is calculated as 6.06% of GNP. The GNP increase would represent gains from economies of scale.
- . They add this to Young's estimate of the cash cost to consumers of Canadian tariffs (which they felt was about 4% of Canadian GNP).
- . They also add the gains to Canadian consumers from increased consumption of previously protected manufactured goods due to lower prices and higher incomes after free trade. Assuming income and price elasticities of unity for all manufactured goods, they estimate these gains to be about 0.4% of GNP.
- . Total benefits would therefore equal 7-10.5% of GNP; the longer the time horizon, the larger the gains.

REFERENCE

Wonnacott, Ronald J., Canada's Trade Options, Economic Council of Canada, Minister of Supply and Services Canada, Ottawa, 1975.

STUDY
OBJECTIVES

- . Revised earlier estimates of bilateral free trade gains.
- . The gaps between Canadian and US wages (used as proxy for the gains of increased productivity in the 1967 study) had closed.
- . Felt wage gap not necessary for gains from free trade to exist because benefits of economies of scale also occur through specialization in areas of comparative advantage.

BENEFITS OF
FREE TRADE

- . Long run gains consist of
 - (a) comparative advantage through specialization
 - (b) recapturing tariff revenue on Canadian exports previously paid to the US government by Canadian producers
 - (c) increased productivity of labour and other factors of production due to economies of scale.
- . Used Willians (1978) study estimate of 2.3% of GNP to capture effects of (a) and (b).
- . Estimated (c) by examining the effect on the real income of Canadian factors of production should free trade eliminate the productivity difference between Canada and the US (about 27% difference).
- . As the 1973 ratio of value added in manufacturing to GNP was 0.22, the gain was calculated as 0.27×22 , or 5.9% of GNP in manufacturing.
- . (a), (b), and (c) totalled 8.2% of GNP or 7-9%, somewhat lower than the 1967 study results.

REFERENCE

Shearer, Ronald A., John H. Young, and Gordon R. Munro, Trade Liberalization and a Regional Economy: Studies of the Impact of Free Trade on British Columbia, University of Toronto Press, Toronto, 1971.

STUDY
OBJECTIVES

- . One of a number of Canadian studies that examines the effects of free trade on one or more regions in Canada. This study estimates the effects on BC of the removal of tariffs among the North Atlantic countries (Canada, US, UK, and the European community).
- . Used a method similar to Young's (1957) based on 1963 data.
- . The effects of long run interregional migration of factors of production are not included. Does not consider the problems of adjustment.

BENEFITS OF
FREE TRADE

Evaluates 4 components of the regional gains from free trade:

- (a) Interregional transfer effects are estimated for the imports of consumer goods from the rest of Canada. Imports are multiplied by an estimated weighted average percentage difference between Canadian and world prices for these goods. Using 1963 trade data and 1966 price data, the effect on BC is calculated to be 1963\$ 55 million on imports of consumer goods from the rest of Canada.
- (b) Similar interregional transfer effects for capital goods are estimated (but tariff rates are used in place of price differentials as price data were not available) at 1963\$ 60 million.
- (c) The cash cost of protected regional production (similar to Young, 1957) is estimated, but applied only to the incremental production induced by protection. The increment is estimated from an analysis of production conditions and (in the absence of price differential data) tariff schedules to be about 1963\$ 60 million.
- (d) Lost revenue on existing exports due to foreign tariffs are estimated, using export and foreign tariff data, to be 1963\$ 10 million.

In total, about \$185 million or 5.5% of the BC Personal Income would be gained under North Atlantic free trade. As these are rough estimates, a range of 4-7% is appropriate.

CONCLUSION

"Western Canada -- and specifically British Columbia -- suffers from being in a customs union with the rest of the country; the central provinces suffer from not being in a customs union with the rest of the world ... North Atlantic free trade would raise incomes in the industrialized regions of Canada relative to incomes in areas like British Columbia, although incomes would rise absolutely in both places. Free trade would be less of a stimulus to economic expansion in British Columbia than in the industrialized central part of the country."

REFERENCE

Williams, James R., The Canadian-United States Tariff and Canadian Industry: A Multisectoral Analysis, University of Toronto Press, Toronto, 1978.

STUDY
OBJECTIVES

- . Uses a general equilibrium linear programming approach to calculate the cost of tariffs by estimating the maximum value of consumption that could be generated by the Canadian economy under both status quo and bilateral free trade. The difference, or additional consumption under bilateral free trade, is an estimate of the gains of free trade to Canada.
- . Uses 1961 input output data for Canada and 1961 Canadian and US tariff data (with some adjustment for Kennedy Round reductions).
- . Considers 103 commodity aggregates, with tariffs computed as weighted averages for each.
- . Assumes fixed coefficients of production, constant returns to scale, and all producers (except resource sector) are price takers on world markets.
- . Does not deal with non-tariff barriers.

BENEFITS OF
FREE TRADE

- . The elimination of Canadian tariffs would increase the value of consumption goods by 1.36%.
- . The elimination of US tariffs would increase the value of consumption goods in Canada by 2.03%.
- . The elimination of both tariffs would increase the value of consumption goods by 3.97% or 2.6% of 1961 GNE (1961\$ 1 billion).
- . Another way of solving the model is to hold all final demand items constant except investment goods. This produces a 5.33% increase in the availability of investment goods from the elimination of Canadian tariffs, a 6.79% increase from the elimination of US tariffs, and a 9.12% increase from the elimination of both tariffs.
- . These estimates are considered underestimates of the long run gains from free trade because the model concentrates on the static resource misallocation effects of tariffs, ignoring scale economy effects.

- . Industries most likely to expand under free trade are those that (i) face high US tariffs, (ii) receive little protection from Canadian tariffs, (iii) have higher input costs due to tariffs, and (iv) produce mostly end products. End product manufacturers should gain the greatest benefits from free trade.

**COSTS OF
FREE TRADE**

- . Small adjustment costs are expected because of the small changes in the relative size of each sector.
- . The bulk of labour reallocation would be within sectors and this is presumed to be less costly than intersector reallocation.

CONCLUSION

"...the tariff has a more inhibiting effect on economic growth than it has on the annual level of consumption. The cost of the tariff measured in terms of investment goods is larger in both percentage and absolute terms.... The tariff has failed to increase the output of end products in Canada above the level that would be expected in free trade."

- REFERENCE Broadway, Robin and John Treddenick, "A General Equilibrium Computation of the Effects of the Canadian Tariff Structure", Canadian Journal of Economics, 11(3):424-46, 1978.
- STUDY OBJECTIVES . Uses a general equilibrium linear programming approach which involves explicit demand and production functions.
- . Based on 1966 data (including input-output tables) to estimate the effects on resource allocation and factor prices of unilateral free trade.
- . Unlike Williams' model, it includes taxes, factor substitution in production, and various values for the elasticities of import supply and export demand (i.e., Canadian exporters need not be price takers on world markets).
- BENEFITS/
COSTS OF
FREE TRADE . Under a wide variety of assumptions, the effects of free trade on an index of Canadian welfare are small -- only gains or losses of 1% or less.
- . Losses in welfare are possible because of the potential for an unfavourable effect on the terms of trade (the ratio of export to import prices) from the removal of tariffs. This would occur if the assumption of Canada as a small, open, price taking economy is not appropriate and our exporters have some monopolistic power in international markets with present barriers.

REFERENCE

Dauphin, Roma, The Impact of Free Trade in Canada, prepared for the Economic Council of Canada, Supply and Services Canada, Ottawa, 1978.

STUDY
OBJECTIVES

- . Used results of Williams (1978) study to estimate the effect of unilateral free trade on the regional distribution of income in Canada.
- . Based on 1971 input-output data to study the effect of eliminating Canadian tariff and some non-tariff barriers.
- . Assumes from Williams (1978) that the gains from unilateral free trade are 2% of Canadian GNP.

BENEFITS OF
FREE TRADE

- . Calculated that real incomes would increase in the Atlantic, Prairie, and BC regions and change little in Ontario and Quebec.
- . However, a significant increase in real wages would occur in Central Canada so all regions would gain from free trade.

REFERENCE

Pinchin, H., Regional Impact of the Canadian Tariff, Economic Council of Canada, Ottawa, 1979.

STUDY
OBJECTIVES

- . Using a technique similar to Young (1957) and Shearer (1971), estimates the size of interregional transfers from consumers in one region to producers in another.
- . This study does not estimate the welfare costs resulting from consumption and production losses induced by Canadian tariffs.
- . Instead the tariff is viewed as a tax on consumers, accruing either to Canadian producers or the government.

BENEFITS/
COSTS OF
FREE TRADE

- . Using Young's (1957) method, the cash cost of Canadian tariffs is estimated at 3.48% of 1970 Personal Income.
- . Estimating the size of interregional transfers is complicated by the need to account for the distribution of government duty receipts, interregional trade in intermediate goods and the effects of the devaluation of the Canadian dollar resulting from unilateral free trade.
- . With a 10% devaluation, the gross cash cost of tariffs declines from 5% of personal income to only 2%.
- . Interregional gains or losses from tariffs are less than 1% of 1970 Personal Income.
- . Some unemployment and migration would occur during an adjustment period after free trade.
- . The purchasing power of all regions would be enhanced by the removal of Canadian tariffs, particularly for Atlantic, Pacific, and Prairie regions, which would no longer have to subsidize protected producers in Ontario and Quebec.

REFERENCE	Harris, Richard G. and David Cox, <u>Trade, Industrial Policy and Canadian Manufacturing</u> , Ontario Economic Council, Toronto, 1983.
STUDY OBJECTIVES	. Modelled the effects of unilateral and multilateral free trade using a static general equilibrium model of the Canadian economy. . Uses 1976 data as a benchmark and divides the economy into 29 industries (20 in manufacturing). . Explicitly incorporates scale economies and imperfect competition effects in manufacturing.
BENEFITS OF FREE TRADE	. Removal of Canadian tariffs increases domestic consumption and compels rationalization of domestic industry. . Under unilateral free trade, Canada's GNP rises 3.49%, welfare increases 4.13% of initial GNE and real wages increase 9.98% from the reference equilibrium level. . Removal of foreign barriers facilitates Canadian penetration of foreign markets, permitting greater economies of scale. . Multilateral free trade raises Canada's GNP 7.02%, welfare 8.59% of GNE, and real wages 25.21%. . These gains are realized from three main sources: (a) resources reallocated from industries where Canada has a comparative disadvantage to industries where it has a comparative advantage; (b) economies of scale from specialization in fewer products, longer production runs, higher volume of output and hence lower unit costs; (c) lower consumer costs from greater competition.
COSTS OF FREE TRADE	. Labour force reallocations will occur between sectors -- 4% of the labour force is affected under unilateral free trade and 6% is affected under multilateral free trade. . Intrasectoral labour force reallocations will also occur, but are not quantified.

REFERENCE

Harris, Richard G., "Summary of a Project on the General Equilibrium Evaluation of a Canadian Trade Policy" in John Whalley, Canada-United States Free Trade, Vol. 11 of the collected research studies for the Royal Commission on the Economic Union and Development Prospects for Canada, University of Toronto Press, Toronto, 1985.

STUDY
OBJECTIVES

- . Applied earlier model to estimate effects of bilateral US-Canada free trade and sectoral US-Canada free trade.
- . Sectoral free trade assumes the elimination of barriers in textiles, steel, chemicals, urban transport equipment, and agricultural machinery.
- . Bilateral free trade assumes the elimination of both tariff and non-tariff barriers (including subsidies) in all industries studied.

BENEFITS OF
FREE TRADE

- . Under sectoral free trade, where trade continues to be supported by export subsidies after the agreement is struck, aggregate welfare increases 1.9% from the base GNE (increase 1.5% without subsidies), the total volume of trade with the US rises 16.3% (13.6% without subsidies), and wages increase 6.9% (5.7% without subsidies).
- . Under bilateral free trade welfare increases 9% from the base GNE, trade with the US increases by 98.7%, and wages increase 28.3%.

OTHER

Sensitivity testing shows the model results are sensitive to several assumptions:

- . The greater the import price elasticities, the greater the industry rationalizations from tariff removal and thus the greater gains from free trade.
- . The greater the export elasticities, the greater the domestic rationalization of manufacturing from more specialized production.
- . The base values of parameters controlling the strength of scale economy effects are uncertain and controversial.
- . The weights attached to the two pricing hypotheses, determining whether prices are set collusively or monopolistically, can affect the gains from rationalization following free trade.

REFERENCE

Royal Commission on the Economic Union and Development Prospects for Canada, Report, Volume One, Supply and Services Canada, Ottawa, 1985.

STUDY
OBJECTIVES

- . Inquiry into the long range economic prospects and challenges facing Canada and its regions.
- . Reviews work by earlier economists and commissions further work and conferences on free trade.

BENEFITS OF
FREE TRADE

Concludes that US-Canada free trade benefits occur in two main areas.

Income and Output

- . Although economists disagree about the size of these benefits, there is no disagreement about whether such benefits occur.
- . In the long term, tariff cut gains will be between 3% and 8% of GNP. This takes account of the effect of tariff cuts already agreed to at the Tokyo Round.

Access to Markets

- . Improved access to US markets through reduced US tariffs and non-tariff barriers.
- . More secure access to US markets through reduced exposure to non-tariff barriers such as countervailing duties or safeguard measures, which increases Canadian firms' ability to make long term investments.
- . Because of improved and more secure access, improved productivity and competitiveness of manufacturing.

Improved and secure access to the US market, and the economies of scale and rationalization of industry which better access will stimulate, will have several effects:

- . Canadian unit costs will drop, increasing productivity.
- . Canadian firms will specialize in more efficient areas of production as a result of US competition, further lowering unit costs and increasing productivity.

- . More competitive Canadian firms will be better able to export to the rest of the world.

- . More trade will create more jobs.

COSTS OF FREE TRADE

- . Some regions may anticipate adverse effects, but it is likely that all regions will benefit and Canadians everywhere will enjoy a higher living standard.
- . Some investment might leave Canada (investors attracted to Canada by current protectionism), but firms now discouraged from investing in Canada by US barriers could be attracted to Canada (in any case, Canada should not use trade barriers to regulate foreign investment, but should use tax and subsidy policies).
- . Disruptive adjustments will be required, but if free trade is bilateral then the elimination of US barriers could increase manufacturing more than it is decreased by the elimination of Canadian barriers.
- . The exact cost of adjustment is difficult to calculate, but previous studies in the US indicate that adjustment costs are between 1/25 and 1/80 of the gains from higher incomes under free trade.
- . Free trade could reduce Canada's ability to negotiate desirable multilateral access to export markets (but it could also increase the pressure for multilateral talks just as the creation of the EEC in 1958 accelerated the Dillon Round in 1960/61). No evidence exists to judge this and Canada should pursue both bilateral and multilateral routes.

CONCLUSION

"These studies have helped to convince us that there is a high probability that Canada would experience significant gains from free trade with the United States."

REFERENCE	Lipsey, Richard G. and Murray G. Smith, <u>Taking the Initiative: Canada's Trade Options in a Turbulent World</u> , Observation No. 27, C.D. Howe Institute, May, 1983.
STUDY OBJECTIVES	. Evaluation of five options for Canada's foreign trade, including three trade liberalization options. . Reviews costs and benefits mentioned by other researchers and commentators.
BENEFITS OF FREE TRADE	. Trade creation as a result of specialization in industries where there is a comparative advantage and hence cost reductions from longer production runs of fewer product lines -- economies of scale. . Cites Harris (1983) and others to conclude that this reallocation of resources from economies of scale would increase Canada's GNP by between 1.3% and 7%. . Additional dynamic gains have not yet been measured, but include: . forcing firms to produce at world competitive costs rather than shelter inefficient practices behind trade barriers; . encouraging labour and capital to reallocate out of declining and into expanding industries; . allowing firms to introduce new products and participate in emerging industries earlier because of access to large, high income US markets.
COSTS OF FREE TRADE	Economic Concerns . Trade diversion (increased trade with the free trade partner and decreased trade with other countries) brings some losses, but also some gains for both US and Canada. Losses occur if US producers can export to Canada, not because they are the lowest cost supplier, but because their tariff free prices are cheaper than tariff burdened prices of imports from other countries. This is a gain to US firms, but at a cost that is paid by Canada, which then has to export more goods for any given amount of imports than before trade diversion occurred. The same cost applies to the US when Canada diverts trade.

- . Dynamic effects can also be negative. If prices, profit margins, and wages do not respond in a flexible way to trade liberalization, then foreign competition may actually reduce Canada's output and employment. Therefore, free trade needs to be phased in, so the economy can adjust, and be accompanied by policies to encourage adaptation.
- . Serious adjustment problems would occur, but the evidence of past adjustments suggests the problem may not be as serious as often believed.
- . While no doubt eliminating some jobs, free trade unemployment impacts would be small compared with forces such as large shifts in interest rates, commodity prices, and exchange rates and should, in any case, be cushioned by special public policies.
- . Free trade may make Canada overspecialized in resource industries, but in the past manufacturing exports have thrived as barriers have come down.
- . Foreign ownership could increase, but Canadian capital would be increasing as a result of the rise in GNP so there would, hopefully, be more room, rather than less, for Canadian ownership.
- . Foreign investment could leave Canada, but several forces would hold foreign capital after free trade (existing plants cannot be moved, tax depreciation write-offs create incentives to reinvest cash flow in Canada, existing subsidiaries would provide their own internally generated funds for new investment, multinationals would serve international market from Canada if production rationalized) and closure of plants solely serving our protected market would be offset by new openings.
- . Head offices could relocate to parent firms. (Although Canadian branches in the US could also relocate to Canada, this would still be a net loss.)
- . Free trade could prevent a Canadian industrial strategy to increase Research and Development if this policy were countervailable, but this is unknown and hypothetical and besides, economies of scale could increase incentives for R&D.

- . Free trade may force Canada to harmonize its tax policies and hence lose its independence or lose capital and labour to a more favourable US tax climate, but this is not certain. Free trade could enable more independence by narrowing the gap in earnings between the US and Canada.

Political and Cultural Concerns:

- . Free trade may possibly result in political union with the US, but the experience of the EEC, attitudes in the US, and Canada's own political resilience all argue against this.
- . Canada may lose world influence or have our political actions constrained because of close ties to the US, but the absence of closer trade ties does not now ensure our independence. In the long term, our independence depends on how much it is exercised, not on trade links.
- . Free trade could erode cultural independence, but if Canadian culture is deeply rooted, trade policy changes should not threaten what is distinctively Canadian any more than it would be threatened by a little more exposure to US media.
- . Free trade could reduce or destroy some private markets and eliminate public policies that support Canada's cultural activities (e.g., subsidies to the arts, Canadian content rules, restrictions on foreign ownership in publishing and broadcasting, lack of foreign ad tax deductability, etc.). However, subsidies should not be affected by trade links. Canadian content rules do not conflict with free trade as they are limits that put our own industries at a disadvantage not barriers to imports.
- . Foreign ownership and tax rules, nevertheless, could be problems, and we must find alternatives to help Canadian industries survive that do not conflict with free trade (such as subsidies) or, if alternatives are not available, we must obtain exemptions for these public policies under any free trade agreement.

REFERENCE	Hill, Roderick and John Whalley, "Canada-US Free Trade: An Introduction", in John Whalley, <u>Canada-United States Free Trade</u> , Vol. 11 of the collected research studies for the Royal Commission on the Economic Union and Development Prospects for Canada, University of Toronto Press, Toronto, 1985.
STUDY OBJECTIVES	. To summarize and introduce research on economic issues surrounding a possible Canada-US free trade agreement.
BENEFITS OF FREE TRADE	. Canadian tariffs cause losses due to misallocation of resource production, a result of tariff induced additional domestic production which is more expensive than importing from international suppliers. . Canadian tariffs cause consumer benefit losses from restricting consumption, a result of raising the price to consumers above prices prevailing on world markets. . Removal of US tariffs would transfer tariff revenue from the US government to Canadian producers. . Access to larger markets would lower prices on Canadian consumption because of economies of scale. . Competition would encourage more efficient production, a rationalization of Canadian industry, and cost savings on production consumed here. . Some regions in Canada would also gain from the lack of protected prices on their interprovincial imports. . The benefits of security of access have not been quantified, but the current possibility of safeguard actions creates investment uncertainty that would be lessened by a free trade agreement (e.g., possible lumber or steel duties). Canada could now suffer as an innocent third party in US trade disputes. These would be less likely under free trade, thus encouraging Canadian investment.
COSTS OF FREE TRADE	. It is not certain whether capital flows into Canada would increase or decrease. The elimination of US barriers would increase capital flows into Canada and the elimination of Canadian barriers would reduce capital flows, but the size of the changes are not known.

- . Exchange rates could become more unstable as a result of free trade, but this should not be significant in the long term. Exchange rates are also affected by other factors.
- . Costs of adjustment as factors of production move within and between industries and regions would be greatest in manufacturing and could amount to about 6% of the labour force being reallocated between industries. Adjustment support programs will be needed in the industries affected.
- . Erosion of sovereignty could occur from US pressure on domestic policies (e.g., regional development policies).
- . Fear of readjustment costs if free trade is terminated could cause a dynamic process of concessions to the US (e.g., resource development issues could be settled in favour of US interests if Canada were to fear the loss of free trade).
- . Free trade could increase our dependence on US markets, restricting our future options.
- . It may contribute further to fractures of the multilateral system along regional lines, but it could also stimulate further multilateral talks. Both options should be pursued.

REFERENCE	Katie Macmillan, "International Trade: The Western Canadian Perspective", Canada West Foundation, Calgary, October, 1984.
STUDY OBJECTIVES	Increase understanding of the international market and discuss the strengths and strategies needed to penetrate it.
BENEFITS OF FREE TRADE	. Barriers benefit mainly Central Canadian manufacturing. Tariff costs alone (total import duties) were \$132.62 per capita and benefited manufacturing employment by \$2,028.58 per manufacturing job in 1983. Applying these rates, the West's net loss (consumer cost minus manufacturing benefit) was about \$416.6 million in 1983, which represents transfers from Western consumers to Central Canadian manufacturers. . Access to larger markets in the US would lower costs and increase efficiency in our industries. . A free trade agreement would exempt Canada from higher American trade barriers and ensure continued access to the U.S. market. . Competition from free trade would help rationalize our industries, resulting in higher wages and productivity and greater specialization in our most efficient sectors, thereby increasing future growth. . Consumers would benefit from lower prices and a wider range of products. . Bilateral free trade with the US would increase our attractiveness for joint ventures from third countries hoping to increase their penetration of the US market, providing jobs, foreign exchange and development capital.
COSTS OF FREE TRADE	. Opponents of free trade claim that rationalization would be at too high a cost. Protected industries would not survive competition, causing hardship for the thousands they employ. However, western Canada is not burdened with protected and inefficient industries unable to survive competition. . Opponents also argue that American corporations would no longer need to maintain subsidiaries in Canada, reducing foreign capital in Canada.

REFERENCE	Katie Macmillan, "Western Perspectives ... International Trade: Problems and Prospects; An Update on the Challenges Facing Western Canada", Canada West Foundation, Calgary, November, 1985.
STUDY OBJECTIVES	Reexamine our export position to help ensure the viability of the export sector.
BENEFITS OF FREE TRADE	.. Tariff costs alone (total import duties) were \$113.75 per capita, representing about \$1,590.04 benefit per industrial worker in 1983. Applying these rates, the West's net loss (consumer cost minus manufacturing benefit) was about \$372 million in 1983. (These figures represent revisions to the estimates contained in the October 1984 publication cited on the previous page.) . Various economic studies estimate overall gains in the range of 3-10% of GNP under free trade.
COSTS OF FREE TRADE	. Manufacturing associations predict the loss of about 25,000 jobs in protected sectors such as clothing, knitting, leather, and textiles. . Opponents of free trade claim Canada's political sovereignty would be compromised. . Canada's social welfare and cultural programs might be jeopardized since these pursuits could be seen as being left to the free market.

REFERENCE	Position Paper on Canada-United States Free Trade by the Executive Council of the Canadian Labour Congress, July, 1985.
STUDY OBJECTIVES	To systematically review the Canada-US trade issue along the following broad lines: the case for free trade, the case against free trade, an alternative to free trade (the "fifth option").
BENEFITS OF FREE TRADE	The paper notes that free trade advocates have seized upon three points: - assured access to the large US market - improved efficiency of Canadian businesses because of exposure to greater competition - multilateral negotiations under the GATT will be too slow and will deliver too little. The paper offers rebuttals to all three points and argues that one implication of free trade is that corporate decision-making in the marketplace will replace public decision-making in the political arena.
COSTS OF FREE TRADE	. Significant job losses in a number of industries, not only in industries subjected to new competition, but also those dominated by US multinationals, the service and retail workers who serve the displaced workers and firms, the transportation and communications sectors designed to serve the "East-West" national economy, and the public sector which will be down-sized because of pressures to follow US patterns of taxation, regulation, etc. . Significant loss in Canadian economic sovereignty, including abandonment of such tools of national economic management as tariffs, quotas, discriminatory procurement, and subsidies. . Imposition of US tax rates, health and environmental regulations on Canada to preserve Canadian competitiveness, and scope for the US to use its leverage to extract "cooperative" behaviour from Canada in non-economic areas. . Reduced financial assistance to Canadian businesses to ensure the Americans that Canadian exports are not unfairly subsidized and growing pressure to ensure that labour legislature and practices in Canada are similar to those in the US.

- . Questions about the US administration's ability to deliver a free trade agreement because many non-tariff barriers are imposed at the state or local level and enjoy a great deal of political support since they protect American jobs.

CONCLUSION

The alternative to free trade is an intelligent and planned industrial policy based on the following priorities:

- reduced dependence on foreign trade
- reduced dependence on raw material exports and manufactured goods imports as a way of creating jobs
- reversing our growing interdependence with the US by diversifying our trading partners
- approaching trade issues on a sector by sector basis.

REFERENCE	Free Trade Could Cost Us Canada. Free Trade: A UAW Analysis. Research and Public Relations Departments, UAW-Canada, 1986.
STUDY OBJECTIVES	To present the position of the United Automobile Workers of Canada on the free trade issue.
BENEFITS OF FREE TRADE	The document offers rebuttals to all of the usual arguments in favour of free trade. The main problem is not viewed as access to the US market (since by 1987 80% of Canadian products will enter the US duty free), but Canada's relatively weak and underdeveloped manufacturing base. The paper further states that a negotiated free trade agreement might not guarantee us immunity against US protectionism.
COSTS OF FREE TRADE	. Severe and painful job losses and job dislocations for workers and their communities. . Possible ending or erosion of the safeguards under the Auto Pact. . Intensification of existing pressures to roll back and limit Canada's social programs and the collective bargaining process. . Limits to Canada's ability to have an alternative industrial strategy through virtually removing our ability to use non-tariff barriers as measures to achieve economic and social objectives. . Threatens Canada's political independence. In essence, free trade means trading off our collective ability to shape our lives -- all those governmental/regulatory "interferences" with competitiveness and the market -- for access to the US market. . Relaxation of government regulations to be competitive with the US.
CONCLUSION	The UAW argues the issue today is how to reduce Canada's dependence on the US market. Rather than free trade, Canada needs an independent industrial strategy to develop a strong economy, full employment, and adequate social programs.

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STUDY
OBJECTIVES

To review the impacts of free trade on Ontario and Canadian manufacturing and workers.

COSTS OF
FREE TRADE

- . Cuts in the living standards and working conditions of Canadian workers in order to make Canada competitive with producers in other parts of the world.
- . Estimated job losses of 250,000 to 300,000 in the Ontario manufacturing sector because of closures of American branch plants and because most Canadian firms do not have the marketing skills or resources to sustain exports on their own.
- . Total dependence on the US for supplies of most essential consumer goods.
- . Erosion or full removal of medicare, workers' compensation, and agricultural marketing boards.

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APPENDIX C

**ALASKA'S ECONOMIC PROSPECTS
AND IMPLICATIONS FOR YUKON**

APPENDIX C

ALASKA'S ECONOMIC PROSPECTS AND IMPLICATIONS FOR YUKON

1.0 INTRODUCTION

The purpose of this working paper is to provide a few basic facts on past and present trends in the Alaskan economy, to briefly discuss the state's future prospects, and to identify possible implications for the Yukon position on the free trade negotiations. The analysis is based on readily available documents, the review of several journals (e.g., The Resource Review produced by The Resource Development Council for Alaska Inc.), and interviews with a few people in Yukon and Alaska. This document should not be viewed as an in-depth analysis of Alaska's future prospects or of possible Alaskan responses to a US-Canada free trade agreement.

2.0 RECENT ECONOMIC TRENDS

The Alaskan economy has experienced boom conditions of unprecedented proportions over the 45 year period from the start of the American involvement in World War II. From 1940 to 1980, the total population of the state increased from 73,000 to 402,000, representing a 40 year growth rate of 4.4% per annum. Total employment rose from 27,000 in 1940 to close to 200,000 in 1980, providing an annual average growth rate of 5%.

Until the 1960s, federal government operations, both military and civilian, dominated the Alaskan economy and established the pace of development. Until the 1960s, military payrolls were larger than the income generated by all of the state's resource extraction and processing industries combined.

Another source of growth through the 1960s was related to the state's strategic location. International air traffic expanded economic opportunities for Anchorage. Combined with the traditional export activities of the fishery and timber, the air traffic growth provided a bridge between the military boom and the later oil boom.

From 1970 on, the exploration for and production of crude oil moved ahead of national defense and other federal programs as the major source of income and economic growth in the Alaskan economy. The 1970s also saw some important structural changes in the Alaskan economy. In the first half of the decade, the economy was dominated by the construction of the Alaska oil pipeline. From 1975 to 1980, the so-called support industries (transportation, communications, trade, financial and other services, and non-defense government) continued to expand. Following the completion of the Alaska oil pipeline, the export base sectors (defense and the commodity producing industries) experienced an employment decrease of 85,000. The continued growth in support sector employment likely reflected a number of factors: lags

between export and support sector expansion, continuing increases in personal income per capita, import substitution, and the overall process of strengthening, deepening and diversification which occurs as a resource based economy passes through certain thresholds of population, employment and income.

The literature suggests that the process of strengthening and diversification has continued through the first half of the 1980s. The sectors exhibiting the strongest import substitution are producers of services rather than goods, including such industries as telephone communications, health services, miscellaneous retail, retail food, business services, banking, insurance carriers, and legal services. Producers of goods serving the local market have experienced only limited expansion in Alaska.

Import substitution has not occurred at the rate allowed by overall market expansion. Therefore, Alaska is still underserved in certain support activities. The Alaskan market is particularly underserved in personal services, amusement and recreation services, medical and health services, wholesale trade, autodealers and service, apparel and accessories, and furniture and home furnishings. Three factors contributing to less than optimum growth in support activities are the relatively limited supply of entrepreneurs in Alaska, the immobility of entrepreneurs outside the state, and lack of market information.

The primary factor behind the growth of the Alaskan economy in the 1980s was state spending on public works based on the state's oil royalty revenues. Other sectors displaying major employment gains were mining, trade, and services. Tourism was also an important source of economic growth. In contrast, employment in manufacturing remained constant at about 14,000 and fish canning and pulp both declined. Although growth in the Alaskan economy has been inhibited by the slump in world oil and gas prices, as yet the Alaskan boom has not turned to bust in the traditional manner.

Projections of employment increases for 1986 and 1987 are typically in the zero to 2% range. These rates are well below the long term growth rate of 5%, but indicate the Alaskan economy still has some strength and momentum.

Alaskans enjoy wages and per capita incomes well above the US average. Alaskans earn, on average, 69% higher wages and salaries per employee than employees in the lower 48 states. In 1983 Alaska ranked first in per capita disposable income (after adjusting for taxes). In this indicator, Alaska was 44% higher than the US average and 26% higher than California. Although the cost of living is also higher in Alaska -- food prices in Anchorage are 10% above the US average and other Alaskan communities are 20-90% above the US norm -- the higher prices only partially offset the higher incomes enjoyed by Alaskan residents. When the state's high incomes are combined with its large population, the dollar

value of the Alaskan market is at least 25 times greater than the Yukon market.

Other aspects of the Alaskan economy that could be important to the analysis of Canada-US free trade are as follows.

- . The Alaskan economy is dominated by one city, Anchorage, with a population close to 200,000. Anchorage accounts for nearly one-half of Alaska's population and employment.
- . There are sharp differences in economic activities and the pace of economic and social development between urban Alaska (largely Anchorage, Fairbanks, and Juneau) and rural Alaska. Rural areas continue to depend on the traditional export activities (fishing and lumber) and renewable resource harvesting (hunting, trapping, and subsistence fishing).
- . Alaska can be divided into three markets: South East Alaska or the Panhandle (population 65,000), Fairbanks/North Slope (population about 100,000), and the remainder of the state centred on Anchorage (population more than 300,000). Because of proximity and transportation links (current and potential), Yukon appears to be in a good position to serve the South East and Fairbanks/North Slope markets, but access to Anchorage and the rest of the state appears more difficult.
- . In 1971, the Alaska Native Claims Settlement Act was passed by the US Congress. The Act resulted in the establishment of 12 regional native corporations which received 40 million acres of land, \$US 462.5 million, and \$US 500 million from oil, gas, and other mineral royalties. Since 1971, many native corporations have become major factors in the state economy, although some are in financial difficulty. Native people in rural Alaska are expressing growing concern about the future, especially after 1991 when shares in the regional native corporations can be traded in the open market. These concerns are detailed in Thomas Berger's book, "Village Journey", which indicates that the villager's subsistence economy could be threatened if land moves into non-native hands after 1991.
- . A number of "megaprojects" are under consideration in Alaska. These include an Alaska natural gas pipeline to tidewater to serve the Japanese market, the Susitna hydroelectric project, and the US Borax Quartz Hill molybdenum mine. However, like Western and Northern Canada, most megaprojects will probably be on hold until world commodity prices strengthen. For example, the Susitna dam project is now projected to be completed in 1999.

- . Alaska's export promotion efforts largely focus on the Pacific Rim, starting with Japan. Japan is already a major market for timber exports, and the Pacific Rim is expected to offer long term market opportunities for Alaskan coal, natural gas, other minerals, and fish products. In 1984, Japan accounted for 71% of Alaska's total exports of \$US one billion. Other major export markets included South Korea (5.4%), China (4.3%), Singapore (3.9%), Phillipines (2.4%), Indonesia (1.9%), and Canada (1.8%). Export sales from Alaska to Canada totalled \$US 19 million in 1984.

3.0 FUTURE PROSPECTS

The fortunes of the Alaskan economy are closely tied to oil and gas production and prices and the royalty revenues generated by oil and gas production. The February, 1985 edition of the Alaska Review of Social and Economic Conditions presented a report on Alaska North Slope oil production and revenue projections. The article prepared three world market price scenarios for oil in order to develop alternative projections of future production and revenues. The three scenarios were as follows.

- (1) The low price scenario assumes a constant real market price schedule of \$US 10 per barrel for Prudhoe Bay oil, roughly corresponding to a world price of \$20 per barrel. Under this scenario, nearly all North Slope development projects would be abandoned. Thus, the low price case represents a lower bound for likely North Slope oil production even if world oil prices collapse. Total projected oil production in the low price case begins falling in 1987 from its approximate current rate of 1.6 million barrels per day (BPD) to 1.1 million BPD in 1990 and 300,000 BPD in 2000.
- (2) For the moderate price scenario, the authors assume that wellhead oil prices remain constant (after adjusting for inflation) at the February, 1985 level of \$17.50 per barrel. Total projected oil production in the moderate price scenario is about 1.5 million BPD in 1990 and about 500,000 BPD in 2000.
- (3) The high price scenario assumes a constant real price of \$25 for Prudhoe Bay oil. This corresponds to the real price which prevailed in 1981 at the historic peak of world oil prices. Total oil production in the high price scenario is 1.7 million BPD in 1990, 1.9 million BPD in 1995, and about 1.3 million BPD in 2000.

The differences between scenarios in Alaska state petroleum revenues received from North Slope oil production are even more dramatic.

Alaska State Petroleum Revenue (\$ Billion)*

	Low	Medium	High
1986	1.6	3.0	4.0
1990	1.2	2.6	3.5
1995	0.5	1.7	3.2
2000	0.3	0.7	2.0

* in constant 1984 US dollars

The report also investigated the potential impact of lifting the ban on the export of Prudhoe Bay oil and other changes to federal regulations which would allow higher wellhead oil prices. These changes could add about 100,000-200,000 BPD to oil production through the 1990s.

The scenarios illustrate the high degree of variability of projected Alaska state petroleum revenues associated with the uncertainty about the level of well head prices. However, under all price scenarios, North Slope oil production declines steadily in the 1990s, reflecting the inevitable decline from the currently enormous production rate from Prudhoe Bay. Even production from new fields that commence over the next eight years would be declining by the late 1990s. The author notes that additional large oil reserves could be discovered in the region by the end of the century. The most promising unexplored areas within state jurisdiction are either offshore or within the boundaries of the Arctic National Wildlife Refuge. Although large discoveries may result from exploration in these areas, the lengthy permit approval process and the high cost of access will most likely defer production beyond the year 2000.

Some newspaper articles in Alaskan papers have suggested that the effects of the current oil price slump, when combined with the inevitable decline in oil production, could be disastrous to the Alaskan economy. Other reports and people we talked to suggested the Alaskan economy could show a surprising degree of resilience over the next five to ten years. Areas of strength could include the following:

- . Because Alaska possesses a significant portion of total US oil and gas reserves, the oil companies have made a long-term commitment to the state. Lower oil prices will mean reductions in oil and gas exploration activity, but exploration could continue at a more measured rate.
- . The Fairbanks area is expected to add 12,000 military personnel in 1987-88. This will stimulate the construction, trade, and other service sectors and will help offset the effects of the oil price slump on the Fairbanks area economy. The total construction cost of the defense project is expected to be \$1.2 billion.

- . The end of the Alaskan boom should mean falling wages, prices, and costs from the inflated levels of the first half of the 1980s. Falling costs should help support local market oriented activities -- trade and other service industries and, perhaps, small scale manufacturing -- catch up with the rest of the Alaskan economy. As occurred in the last half of the 1970s, growth in support sector employment could offset declines in export based jobs. A number of studies reviewed by the Study Team emphasize there is considerable scope for import substitution and for deepening of the Alaskan economy.
- . The state government could help to maintain capital expenditures by drawing down its "Heritage Fund" (the petroleum revenues built up in previous years) and by increasing state income and other taxes which are currently very low. Because the Alaskan population expanded so rapidly, there appears to be a backlog of housing and infrastructure requirements which need to be satisfied.

For these and other reasons, some of the people we interviewed believe that the Alaskan economy could experience a stall in growth over the next five years, but not a sharp decline in economic activity. One respondent suggested that if oil prices remain at the very low levels of the early Spring of 1986, Alaskan employment could decline by about 10% to the level which prevailed in 1981. If oil prices return to the 1985 level, Alaskan employment could remain at the 1985 peak. Under either scenario, Alaska would continue to offer a comparatively large market for Yukon producers and service firms interested in market diversification and expansion. The above evidence suggests the bust that typically follows an Alaskan boom may not happen this time.

This view is consistent with longer-term projections for the Alaskan economy prepared for the study, "Regions and Resources: Strategies for Development" (David T. Kresge et al.). The author's projections call for growth of about 1% per year in Alaska's population, and close to 3% per year in employment through the rest of this decade and the last decade of the twentieth century. Disposable income per capita (in terms of constant dollars) is expected to expand by about 2% per year.

The projections suggest that comparatively little growth will occur for the rest of the decade, but modest economic gains will be realized from 1990 on. The last five years of the 1980s is seen as a period of retrenchment after the major swings in economic activity of the recent past. The moderate growth of the 1990s reflects steady expansion in state and local government spending, steady growth in Alaska's non-oil resource based industries (e.g., forestry and fishing), and service sector expansion in response to income and population gains. Through the period, support sector employment is expected to advance at a significantly faster pace than export base employment.

The documents reviewed for this working paper suggest the Alaskan state government and private sector could respond in a number of ways to the current and projected economic situation. Possible responses could include the following:

- maintaining state capital expenditures to expand the housing stock and improve physical infrastructure
- expanding export promotion efforts in the Pacific Rim
- lobbying Washington to lift the ban on oil exports to allow sales to, for example, the Lower Mainland of British Columbia
- expanding efforts to promote economic diversification and import substitution opportunities in the areas of trade, services, and perhaps small scale non-resource based manufacturing
- continuing efforts by state legislators to institute "hire local" laws and other measures to ensure Alaskan workers and companies benefit from the economic development that takes place (To date, Alaska has been relatively open to out-of-state suppliers and investors. The debate over local hire suggests Alaska could erect non-tariff barriers of its own over the next few years.)
- increasing efforts to stimulate agriculture and other renewable resource activities
- expanding the role of the private sector in Alaskan economic development.

4.0 IMPLICATIONS FOR YUKON UNDER A CANADA-US FREE TRADE AGREEMENT

The people we interviewed and the very limited data available on exports from and imports to Yukon indicate that Alaskan businesses have not been active in selling goods and services in the Yukon market, and that Alaskan investment in Yukon is largely restricted to the tourism sector. Five hypotheses can be offered to explain Alaska's limited interest to date in Yukon:

- (1) Over the past 15 years, the Alaskan economy has grown so quickly that Alaskan businesses have had difficulty keeping up with the growth in local demand. In many cases, there was no excess production available for export.
- (2) Alaskan prices and costs have been very high, making Alaskan goods uncompetitive in the Yukon market, especially in light of the sharp decline in the Canadian dollar.
- (3) Once fish products, pulp, and other forest products are excluded, the Alaskan manufacturing base is very limited. Alaska produces very few manufactured goods that could be required by Yukon consumers. The Alaskan economy is 25 times larger than the Yukon economy, but in many respects it may be just as undeveloped and immature.

- (4) The Yukon market is very small compared to the Alaskan market and therefore, in some cases may not offer sufficient sales potential to generate Alaskan interest.
- (5) The state's export promotion efforts are focussed on selling resource products to Pacific Rim markets.

For these and other reasons, Alaskan government and business people appear to have given little thought to what a Canada-US free trade agreement might mean to the state economy. On the other hand, our respondents noted that Alaska is interested in strengthening social, cultural, and business ties with Yukon and indicated that Canadian products are well received in the Alaskan market. Over the past two years, the Whitehorse Chamber of Commerce sponsored two business missions to Alaska which may have rekindled interest in establishing business and other links between Yukon and Alaska.

The discussion above could lead one to assume that Alaskan producers will not pose a threat to Yukon businesses in the event of free trade. This assumption could be a mistake. Prices and costs in Alaska are already starting to adjust downward in response to economic conditions. Any strengthening of the Canadian dollar (e.g., in response to stronger international markets for non-oil resource commodities in the late 1980s) would add to the competitiveness of Alaskan goods in their own market as well as the Yukon market. Alaskan efforts to diversify the state economy and replace imports could make Alaskan goods even more competitive.

The potential exists for many Yukon producers to sell successfully in the Alaskan market in the event of free trade, and not face Alaskan competition in the territorial economy. However, each situation should be looked at on its own merits, and with the full knowledge that the relative prices and economic conditions that prevail today may not be relevant in the early 1990s when a free-trade agreement could be implemented.

Because so little is known about Alaskan markets and the potential competition from the state, the Study Team proposes that the YTG conduct further research on the Alaskan market and economy. The Study Team also suggests the YTG meet with Alaskan politicians and officials (as well as with representatives of the NWT) to discuss the mutual benefits and areas of common concern associated with Canada-US free trade. They could also discuss the possibility of a common northern strategy for the free trade negotiations.

Finally, we endorse further trade and business missions to Alaska. Our respondents suggest that both sides benefit from these missions. Both Alaska and Yukon benefit from the stronger business, trade, and personal links that result. One respondent suggested Yukon businesses benefit in particular from the exposure to the spirit of

entrepreneurship and risk-taking prevalent in the Alaska business community.

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MAJOR FACTS ON ALASKA

Total Population

1920	55,036
1940	72,524
1950	128,643
1960	226,167
1970	302,173
1980	401,853
1984	500,000 ^e
1985	523,000 ^e

Population of Major Cities

	1970	1980
Anchorage	48,081	173,017*
Eielson Air Force Base	6,149	5,232
Fairbanks	14,771	22,645*
Juneau	6,050	19,528
Kenai Peninsula Borough	16,586	25,282
Ketchikan	6,994	7,198
Sitka	3,370	7,803

* The current population of Anchorage is estimated at 200,000 and the total population of Fairbanks and area is 75,000.

Economy

Primary Industries: oil, gas, tourism, commercial fishing

Principal Manufactured Goods: Fish products, lumber and pulp, fur products

Chief Crops: barley, hay, silage, potatoes, lettuce, milk, eggs

Number of Farms: 1,000 (1983)

Acreage: 2 million (1983)

Farm Income: \$US 18.8 million (1983) (cash receipts from marketing)

Timber/Lumber: spruce, yellow cedar, hemlock

Forested Land: Total land area - 363 million acres

Area forested - 119 million acres

Percent forested - 33%

Minerals: Total Value (1984) - \$US 98.7 million

Main Minerals - sand and gravel, crushed stone, gold

Commercial Fishing: \$US 543.9 million (1983)

Value of Construction: \$US 1.8 billion (1984)

Employment Distribution (1983):

	No. ('000)	%
Total	209.5	100.0
Mining	8.2	3.9
Construction	18.0	8.6
Manufacturing	13.9	6.6
Trans/Comm/Utilities	18.8	9.0
Trade	41.1	19.6
Fin/Real Estate	10.5	5.0
Services	38.6	18.4
Government	60.5	28.9

Per Capita Income:

Alaska	- \$17,155 (1984)
Washington	- \$12,728 (1984)
United States	- \$11,675 (1983)
Canada	- \$10,193 (1982)
Yukon	- \$14,282 (1983)

Unemployment: 10.0% (1984)

Tourism: Spending of out-of-state visitors - \$US 535 million (1983)

APPENDIX D

BARRIERS TO TRADE IN SERVICES

APPENDIX D

BARRIERS TO TRADE IN SERVICES

1.0 INTRODUCTION

Over the past six months, DPA has completed two assignments which address the issue of barriers to trade in services. The first was for the government of Alberta and the second for the government of British Columbia. The purpose of this appendix is to summarize the major conclusions from the two studies and other related assignments completed by DPA on service industries.

2.0 INDUSTRY BY INDUSTRY ANALYSIS

The following industries are those with the greatest number of severe barriers to trade or investment.

Air Transport

- . Barriers are a very important factor restricting service exports in this industry.
- . Canadian carriers want more access to the US international market, but negotiations on a new bilateral agreement must also resolve some problems -- US carriers enjoy preclearance of US customs when flying from Canada to the US and they also operate regional hubs in the US, putting Canadian carriers at a disadvantage.
- . Canadian specialty air services do not feel they can compete with the US firms if they have to maintain Canadian staff and equipment standards.
- . Even outside the bilateral agreement restrictions, Canadian private carriers are not happy with Air Canada's large share of the Canada-US routes.

Water Transport

- . BC shipping firms generally get business to the US only when the goods originate in BC.
- . There are no barriers in deep sea shipping except shipping conferences. Domestic shipping is restricted to domestic vessels in both the US and Canada (although waivers can be obtained in Canada).
- . The US restrictions (cabotage under their Jones Act) forcing US firms to use US vessels enables Canadian shippers to use cheaper foreign flag vessels, hence giving Canadian shippers an advantage over US shippers of the same goods. (This benefits Canadian goods, not service industries.)

- . A new Canadian Shipping Conferences Exemption Act is expected in a few months with changes to make it more like the US Act; (the changes will require less shipper commitment to conference ships and will allow some independent actions by transport companies).

Truck Transport

- . BC firms have some problems with US fuel and sales taxes and State regulations, but they get national treatment. Immigration laws prohibit work on domestic US routes, but not for transborder routes.
- . US firms complain that provincial motor carrier commissions discriminate in licensing. This will be an important issue in trade talks.
- . Canadian firms fear being swamped by bigger US firms.

Telecommunications

- . New technology is rapidly changing this former utility industry. BC Telephone's monopoly has been challenged by many firms.
- . BC Tel does not feel barriers are important in their business. They export little to the US, but feel there are few barriers to doing so.
- . Current lower deregulated long distance rates in the US are drawing Canadians to go through US systems, using firms that resell US leased lines. This encourages trade, but BC Tel is concerned that it harms Canada's telecommunications industry. Meetings of carriers and the CRTC are trying to find solutions. (In a few weeks, similar lease line resales could also occur in the Canadian domestic long distance market. These resales may have BC Utility Commission approval.)

Broadcasting

- . BC firms generally do not try to export their services (sell ads) to the US and are not usually interested in the US market.
- . Broadcasters feel some Canadian barriers are vital to the industry because of Canadian content regulations -- ad spending deductability under C-58 and simultaneous program substitution on cable TV both provide subsidies to Canadian broadcasting that make up for the disadvantage of their Canadian content requirements. Reducing or eliminating the subsidies without changing content requirements could cause broadcasters in BC to lose \$25-30 million to US broadcasters, one-third of their revenues.

Banks

- . Banking is probably the most heavily regulated industry examined.
- . Canadian banks do considerable business in the US. Although some states do not allow foreign banks many states do allow foreign subsidiaries or representatives. The US policy is generally quite liberal (it actually favoured foreign banks over domestic banks until the International Banking Act of 1978). Canada allows only a limited amount of foreign controlled banking.
- . Foreign banks in Canada complain about many aspects of their regulations but only the limits on foreign equity in Schedule A Banks and the restriction on foreign bank branches are actually severe. Foreign banks can set up subsidiaries (Schedule B Banks), but then face a host of regulations, discretionary supervision, and overall limits on their share of the market.

Investment Dealers

- . Together with all financial services, investment dealers are undergoing considerable restructuring, moving toward a multiservice or supermarket financial concept.
- . Barriers are not important to Canadian dealers exporting their service to the US. Risks related to firm size and lack of export financing are more constraining because the US operates an essentially open market once firms are established.
- . Canada has strict limits on foreign ownership (Toronto Stock Exchange and Investment Dealer Association regulations), although the trend is toward increasing the share of foreign ownership allowed. The elimination of ownership limits could hurt Canadian firms by allowing large US investment firms to establish in Canada.
- . On the other hand perhaps US firms would also bring more investment from the US.

Life, Property, and Casualty Insurance

- . Few insurance firms are headquartered in BC, hence few export services to the US.
- . Another reason for not exporting to the US is the exposure to large litigation suits in US courts.
- . US firms are not usually interested in the small BC market, which is even further reduced by government involvement in insurance.

- . Barriers are still an important constraint on trade, both in Canada and the US. Doing away with licensing, reserve and capitalization requirements would open up more trade, but this would result in less control of insurers and could benefit the larger US firms more than Canadian insurers.

None of the business or cultural service industries are as heavily regulated as transport, communications, or finance. Nevertheless, several have severe barriers that could be important in upcoming trade talks.

Computer Services

- . Some large Canadian firms do business in the US, but barriers are only one factor constraining trade. Risks related to firm size and lack of export financing are more important.
- . The major Canadian barriers to US firms are discretionary investment restrictions under Investment Canada and less strict software copyright protection in Canada.
- . As part of a growing industry, computer service firms generally feel they could benefit from free trade.

Accounting

- . There is little or no trade in accounting services because of certification requirements in both countries. Certification in Canada recognizes US education, but US certification does not recognize foreign credentials.

Architectural, Engineering, and other Scientific and Technical Services

- . The major barrier for Canadian engineers exporting to the US is government procurement that favours local firms. US firms exporting to BC face similar barriers.
- . There is some trade across the border, usually when the exporter has a unique skill or technology, but Canadian firms are less limited by trade barriers than by other factors such as lack of market information and skills, distance from markets, or risks related to firm size.

Lawyers and Notaries

- . There is no trade between the US and Canada, although some law firms have affiliations. (Barriers exist even for interprovincial law services.)
- . The Law Society of BC requires foreign lawyers to obtain Canadian citizenship.

- . Some lawyers feel they could benefit more from the reduction of barriers in other industries than from the reduction of their own barriers.

Cultural Industries

Cultural industries have some barriers, but few, if any, that actually prohibit trade or investment. Concern about free trade is greatest in these industries because of the fear that free trade talks would eliminate support programs for culture.

Aside from support programs, culture industries now operate in a largely free trade environment. Some in the industry complain that Canada is treated as part of the US domestic market and want more barriers. Exporting to the US is very difficult because of the large and competitive US industry, and some Canadian firms are satisfied with the Canadian market. Benefits from more free trade in culture industries are uncertain. Some feel that only US firms would benefit while Canadian firms would suffer; others feel that both would benefit to the limited extent barriers now constrain trade.

Two important barriers that affect all industries to some extent must also be highlighted:

Work Permits or Commercial Visas. Many Canadian industries consider US work permits more restrictive than Canadian. This was especially noted by respondents in the architectural, engineering, and other scientific and technical services, management consulting services, and staged entertainment industries. Many Canadians feel they must simply lie about the purpose of their visit to gain entry to the US.

Investment Canada. Under Investment Canada, US investments can be limited. Although considered an improvement over FIRA, Investment Canada still gives discretionary power to limit investment and impose "voluntary" performance conditions. Much depends on how the federal government implements the new legislation and will be a major topic in free trade talks.

3.0 CROSS SECTORAL ANALYSIS

The following points illustrate other findings from DPA's past research on service industries.

- . Out of country exports are actually (or potentially) important to the following service industries: engineering consulting, management consulting, architects, computer services, air cargo and leasing, trucking, agriculture and other resource related services, and real estate management and development.

- . Head offices have a greater propensity to export than branch offices.
- . Tariff barriers are not a major impediment to service sector exports. Non-tariff barriers, however, are a serious constraint. Relevant NTBs include customs delays, government bids issued at short notice, foreign exchange/currency restriction, import licenses and permits, enforced use of local agents, immigration laws, and compulsory local content requirements.
- . Barriers internal to the firm, e.g., small company size, lack of knowledge of export markets, lack of export financing, and limited export marketing personnel, can be of greater concern than trade or external barriers. DPA's research suggests that many service companies may underestimate the importance of non-tariff barriers, viewing them as simply a cost of doing business, not as significant impediments to export sales which can be reduced through trade negotiations. In many cases they may be right, but the exceptions could be important.
- . Many respondents to DPA surveys expressed general support for reduced trade barriers and free trade, but wanted protection for their industry and firm to continue and are concerned about loss of Canadian control in their industry.
- . There are no generally accepted definitions as to what constitutes a barrier to trade in services. There is universal agreement that a duty on an imported good constitutes a barrier to trade. No such consensus exists on many non-tariff barriers to trade in services. Subsidies or government regulations perceived as trade barriers by one government can be viewed as necessary national policy instruments by the implementing government.
- . There is a general perception that the US has fewer barriers to trade in services than Canada or other countries. This perception is held by the US government and helps explain the emphasis the American government is expected to place on services in Canada-US free trade negotiations.

DPA's research suggests that while the perception may be generally accurate, there are many serious barriers to trade in services in the US operating at both the federal and state levels. The US state barriers may be less well known or obvious. In light of the very large service markets these barriers are designed to protect, the US barriers to trade in services may be just as significant as the barriers of Canada and other countries. The incidence and effects of US service trade barriers should be researched carefully by the Canadian federal government before embarking on the free trade negotiations.

- . Free trade in services will require reducing NTBs that restrict inter-provincial trade in Canada and inter-state trade in the US. Many of the NTBs play important roles in the economic policies of individual states and provinces and therefore will not be easily lowered. The US federal government could have just as much difficulty as the Canadian government in ensuring that states reduce trade barriers under their jurisdiction.

Many barriers to trade in services are complex in their operation and effects and their impacts are not always obvious. They are not straightforward, like a duty on an imported good. The same barriers can operate in different service industries -- often with different effects -- and often barriers are interchangeable (remove one barrier and another will begin to operate with the same force). Some can operate in a subtle manner and are based less on the wording of a law or regulation than on how the law or regulation is interpreted or administered. Service trade barriers operate with different force on different sized companies. Many are no more than a nuisance to large companies, but can act as a severe impediment to a small firm. (The costs of circumventing a barrier can be similar, regardless of company size.) Transparency, consistency in wording and application, and common North American standards would help small more than large companies.

Small Canadian companies could be particularly hurt by the service trade barriers operating at the US state level and by the differences in barriers among the 50 states. A small company does not have the time, financial resources, or expertise needed to research barriers at the state level and work out strategies to circumvent them. For Canadian companies interested in selling in many states, the operative barrier may be the most restrictive one. This situation adds to the trade restricting potential of non-tariff barriers implemented at the state level.

Many service trade barriers are an integral part of economic policy formulation in Canada, the US, and other countries. For Canada, reducing service trade barriers is virtually indistinguishable from the process of government deregulation. To the extent that governments support deregulation, the free trade negotiation may be a good mechanism to accelerate the deregulation process. If deregulation does not have broad support in Canada, Canadian governments will have to be very careful about which service trade barriers are placed on the free trade agenda.

4.0 IMPLICATIONS FOR YUKON

Although the implications of DPA's research on service trade barriers for Yukon's negotiating position are far from clear, a few points can be made.

Alaska appears to be one of the more open US states in terms of establishing companies and related trade in services. The few Yukon companies that have set up wholly owned subsidiaries in Alaska encountered no difficulties in establishing their Alaskan business and competing for Alaskan contracts. In fact, two respondents stated that working in Alaska was like a "breath of fresh air" after operating in the highly regulated Canadian market. The possibility exists, however, that Alaska could become more restrictive as state politicians and businesses respond to the downturn in the Alaskan economy. The debate over local hire laws could broaden to include preferences for state owned businesses.

Few Yukon businesses would be directly or immediately affected by freer trade in services. A possible exception is Yukon air carriers which could be directly affected if free trade resulted in further deregulation of the airline industry.

Two opposing factors could influence the long term effects. Many Yukon service establishments are branch offices of southern based companies. DPA's research suggests that branch offices are less interested in exporting and therefore may respond less than head offices to the opportunities afforded by reducing barriers to trade. On the other hand, our research indicates that small companies are especially hurt by service trade barriers. Reduced barriers to trade in services, therefore, could be highly supportive of YTG efforts to develop Yukon owned companies in the higher order services (engineering consulting, management consulting, accounting, architecture, and other business and professional services).